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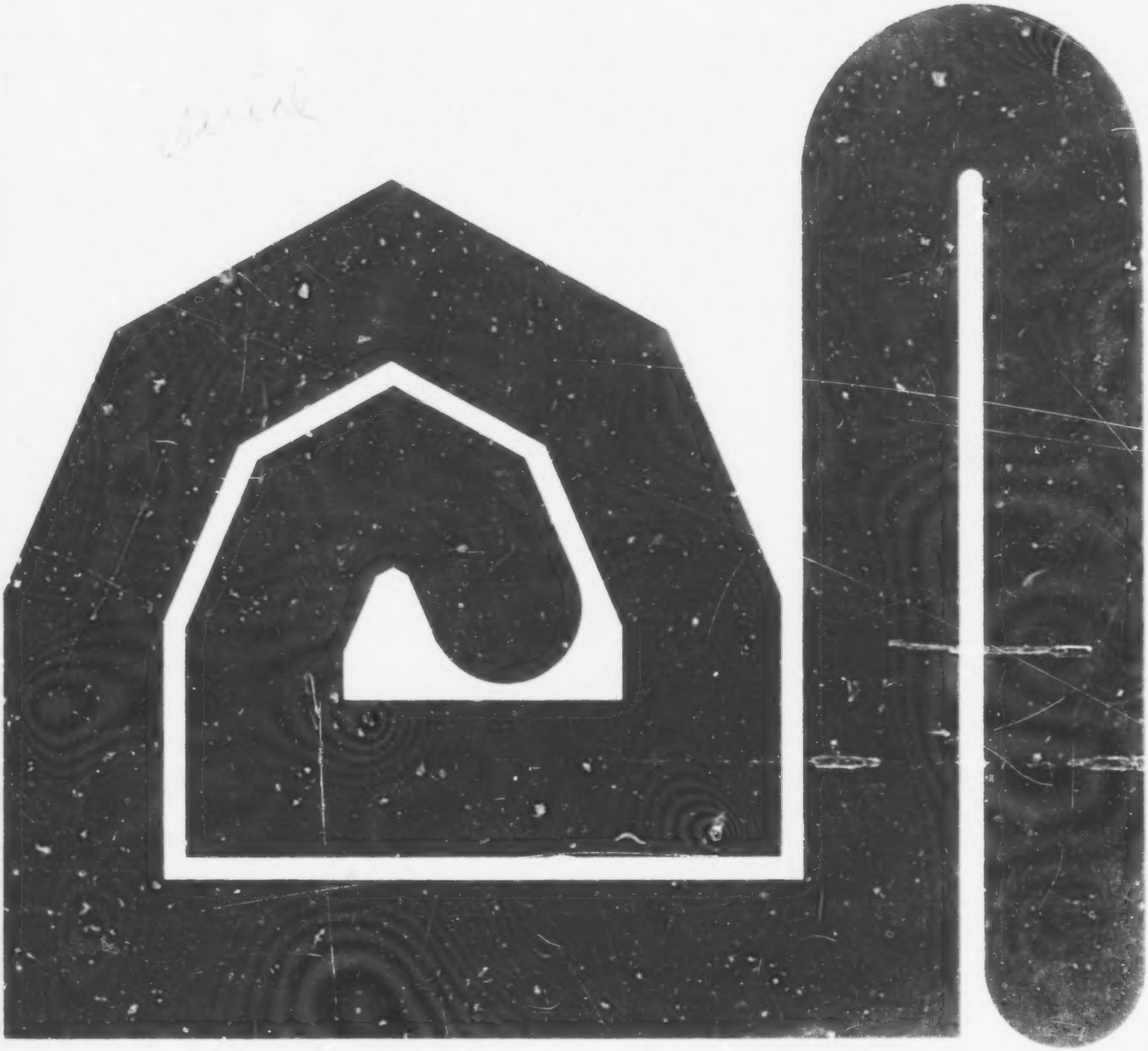
AGRICULTURAL AND CREDIT OUTLOOK '84



FOREWORD

A team of Farm Credit System and Farm Credit Administration personnel undertook a project of interpreting and summarizing the agricultural and credit outlook for 1984. The team represented a broad range of expertise in agricultural economics and credit. This was the twelfth year of an effort to focus attention on the agricultural economy and to look at prospects for agricultural finance in the coming year.

The activity provides a once a year overview of the interactions of various commodity situations, production input costs, trends in output utilization, and changes in stock levels. A timely digest of these influences provides a point of departure for independent judgments and plans of operating in providing agricultural finance to farmers and their cooperatives.

The outlook presented herein was developed concurrently with USDA's annual agricultural outlook conference (October 31–November 3, 1983). The report presents a more detailed assessment of the general economy and of agricultural credit conditions by FCA analysts—Ralph Chite, Steven Guebert, Edward Harshbarger, Lucy Huffman, and Roland Wentzel. Donald Riffe (Director of Research, FICB-Omaha) served as integrator of the commodity Chapter.

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A sustained recovery will continue in 1984 with real GNP growing 4½ to 5 percent over 1983 levels.	1
Consumer spending should continue to contribute to the recovery; consumers have ample room to support additional installment debt and can expect growth in real earnings.	1
The continuing expansion will lead to moderate improvements in employment, with the yearend unemployment rate well below 8 percent.	2
Business spending growth in 1984 will come from inventory rebuilding early in the year and from continuing capital spending throughout the year, fueled by increases in corporate profits.	3
Congress is unlikely to pass any revenue increases in 1984; thus the budget deficits are expected to be near $200 billion for FY 1984-1986, raising the possibility of "crowding out" of private credit needs during 1985.	4
The trade deficit for 1984 is expected to top $75 billion as high U.S. interest rates continue to put upward pressure on the dollar while the world recovery spreads slowly.	5
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A declining share of a declining market has shaken the ardor that American agriculture has had for foreign markets--our volume of agricultural exports will slide again, though higher unit values could reverse the recent dip in total value.	16
Farm policy issues will be a major topic of public debate during 1984. Among the most important issues is the relationship between domestic farm policies and the capacity of the United States to compete in world markets.	18

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AGRICULTURAL FINANCE OUTLOOK

The farm income and financial situation of farmers is probably as uneven as it has ever been owing to the drought, PIK, and various other developments of the past several years. 20

Loan servicing requirements in 1984 could be more demanding than those of the year just ended. 20

Farm sector equity declines of 1981 and 1982 were reversed during 1983, though real gains were probably near zero. Similar results are projected for 1984. 22

Farm Credit System delinquencies reached seasonal peaks in the first quarter of 1983 before ratcheting downward in the second and third quarters; however, the levels were higher than in the same periods of 1982. 23

While farm financial stress has been widespread, most System bankers anticipate an improvement in credit quality for some farm enterprises in 1984. 24

A mid 1983 American Bankers Association survey of agricultural commercial banks showed little change in credit conditions, though fewer borrowers were expected to be discontinued in the year ending June 30, 1984. 25

The repayment experience of Farmers Home Administration farmer-program borrowers slightly worsened in fiscal 1983. Although there was strong seasonal improvement during the year, the delinquency rate was 28.4 percent at the end of the fiscal year compared with 24.6 percent a year earlier. 26

Agricultural cooperatives are expected to show improvement following 2 years of generally weak financial performance. 27

The slowdown in System lending activity that began in the middle of 1982 continued into 1983—for the year ending September 30, outstandings declined 0.5 percent. 28

Continued weak demand for both real estate and production credit limited the System's financing needs and contributed to the first calendar year paydown of the System's bond portfolio in recent history. 30

Farm loans outstanding at commercial banks increased 7.2 percent for the year ending June 30, 1983, due to the strong liquidity position of commercial banks and narrowing interest rate differentials between banks and PCAs. 31

Large gains in CCC loans outstanding during most of 1982 and early 1983 reflected burdensome grain stocks, low commodity prices and liberalized rules for putting grain directly into the farmer-owned reserves. With liquidations of CCC loans and a lower participation rate in the 1984 farm programs, CCC's prominence will lessen in 1984. 33

FmHA lending activity in its 4 major farm programs fell considerably short of budget levels in fiscal 1983, primarily because of an overestimate of emergency disaster lending and the continued impoundment of funds in the economic emergency program. 35

In 1984, lenders will continue to stress the ability of the farm operation to service debt, the quality of the collateral, and the actions available to minimize risk exposure. 36

OUTLOOK FOR COMMODITIES

Major variables shaping the price outlook for feedcrops and livestock suggest the potential for another income reversal for these sectors if crop growing conditions prove favorable. 37

Continued large meat supplies will keep downward pressure on cattle, hog, and poultry prices through mid-1984. 37

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Projected increases in feed supplies accompanied by lower prices would encourage expansion by both the cattle and hog industries, resulting in shorter red meat supplies and higher prices in the second part of the year. 38

Improving economic conditions should mean greater meat and poultry demand by consumers, thus aiding the prospect for a return to favorable producer margins in the second half. 38

The dairy outlook is one of concern as reduced profitability points to adjustments that will affect both the dairy and the meat sectors. 41

A paid milk diversion program is to be offered in January, though the Secretary of Agriculture may modify the planned reductions and proposed culling patterns of dairy producers if adverse impacts are seen for red meat and poultry producers. 41

The 1984 crop programs are relatively unattractive to producers and are likely to have only a marginal impact on restricting acreages. 43

Corn production could exceed 8 billion bushels, as high pre-planting prices and unattractive programs could stimulate record crop plantings. 43

The relatively ample availability of other feed grains and wheat is significantly moderating a tight corn situation during the 1983/84 marketing year. 44

Despite the largest acreage adjustment program in history, 1983 saw the third largest U.S. wheat crop and 1983/84 domestic carryover stocks of wheat will be only marginally below those of 1982/83. 44

Efforts to regain prior U.S. wheat export levels are complicated by continued increases in wheat production outside the U.S., greater competition from the EC, and a comparatively strong dollar. 44

Limited soybean supplies mean a strong potential for volatility in soybean prices. A large Southern Hemisphere crop appears likely, though in the U.S., early new crop futures have favored corn plantings over soybeans. 46

The near-term optimism for cotton prices is tempered by large world supplies and the prospect for a large increase in U.S. production during 1984. 46

Large tobacco carryovers mean that a sizable oversupply of U.S. tobacco remains even after a sharp production drop during 1983. New legislation should assist growers in 1984. 47

Variable weather conditions held production of major fresh vegetables slightly below 1982 levels. Demand for fresh vegetables has continued to increase, reaching record highs in 1982. 48

Production of processing vegetables was down in 1983 with the frozen pack off 17 percent and canned off 6 percent; but with a large carryin and a continued shift in demand to fresh vegetables, supplies are adequate.

Total U.S. potato production for 1983 was down 6 percent due to reduced acreage and weather-related problems. The 1983/84 season average price is expected to be up. 49

Although fruit and nut production decreased substantially during 1983, ample supplies of the two major fresh products—apples and oranges—and large inventories of most processed fruit and nuts depressed prices. 49

Gradually improving demand for lumber and wood products is expected because housing starts will likely increase slightly, reflecting moderation of interest rates and continued economic growth during 1984. 50

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I. GENERAL ECONOMY

Summary

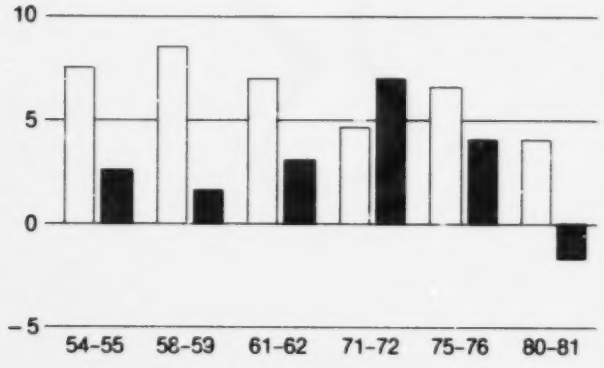
The economic recovery, which marked its beginning in November 1982, is now 1 year old. Spurred by slowing of inventory liquidation, consumer spending pushed real GNP to a strong 9.7-percent growth rate during the second quarter, following an anemic 2.6-percent growth rate in the first quarter. The rate of recovery slowed to a more manageable level in the latter half of the year as consumer expenditures steadied, signalling a moderation in production growth.

The investment phase of the business cycle has begun a response. The sharp second-quarter growth in production and in factory utilization prompted increases in business outlays for capital equipment. This upturn in investment continued through the year, mirroring the production gains. The gains in corporate profits stemming from productivity increases are bolstering the investment expansion.

The recovery is expected to continue through 1984, with real GNP likely to grow at a rate of 4.5 to 5 percent, because of the following factors. Business investment spending will continue to rise, reinforcing the growth in consumer expenditures through higher employment and income. The sizable fiscal thrust from the unprecedented deficit in the Federal budget is certain to contribute to growth throughout the year. Exports may enjoy a modest increase, as the recovery process finally begins in the Latin American countries while continuing in the industrialized countries. Finally, monetary policy will continue its current course, allowing interest rates to average slightly lower over the year.

Real GNP Growth in First and Second Years of Expansions

Percent Growth Rate



Source: Data from the American Enterprise Institute.

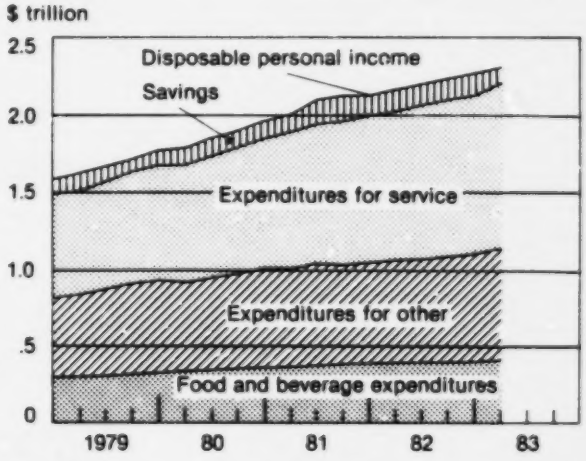
The challenge will be to maintain the recovery beyond 1984. As the recovery proceeds into the investment phase, the growth in demand for funds by private business will pick up, as will demand by households for housing and durable goods financing. If the government deficits remain at currently projected levels, private demand for funds is likely to exceed the supply of funds available at current interest rate levels. Thus, interest rates are likely to begin to rise toward the end of 1984 and climb during the year following. Such a rise could stunt the growth of private investment and weight the expansion toward consumption (and defense) expenditures, rekindling the stagflation of the latter 1970s.

Consumer Demand

After showing some improvement in late 1982 in autos and housing, consumer spending weakened in the first quarter of 1983, dampening the beginning of the recovery. Total retail sales declined in both January and February.

Signals of a true turnaround in consumer spending began to appear in March. Personal and disposable income both increased 0.6 percent (after smaller increases in January and February), with the growth due largely to a jump in wages and salaries. The wage growth reflected the change in inventory policy and the strong performance of the housing industry in the first quarter.

Personal Income and Expenditures



1983 preliminary. Seasonally adjusted annual rate.
Source: U.S. Department of Commerce.

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The job gains and income growth lifted consumer confidence and brightened the spending picture. Total sales increased somewhat in March, but rose strongly in April and May to lift second-quarter sales 5.9 percent above the first quarter. Second quarter durable goods sales rose 32 percent over the first quarter, an indication of the pent-up demand for these postponable discretionary items.

The spending pace far outran income gains. While real expenditures were increasing at a 10 percent annual rate in the second quarter, real disposable income rose at the same 2.9 percent annual rate as in the first quarter. Thus, the personal saving rate dropped to an extremely low 3.9 percent, presaging the summer pause in spending. The retrenchment, combined with the boost in personal income from the July 1 tax cut, restored the saving rate to a more normal 4.5 to 5 percent.

The growth rate in real expenditures during the second half of the year was expected to be 4.5 percent (compared to the 10-percent growth of the second quarter), reflecting the modest growth in salaries and wages, as well as a more normal saving rate.

The outlook for 1984 consumer spending will depend on consumer income gains, particularly with regard to wages and salaries; consumer wealth positions, primarily the value of ownership in homes and stocks; consumer financial position or the ability of income to support installment credit debt typically used for durable purchases; and consumer confidence levels. Consumer income gains, relatively strong this year, will probably taper off somewhat as the economy settles into a more stable growth phase after its initial burst. Real disposable income should increase at around a 4 to 4.5 percent annual rate, the result of a steady upward wage trend combined with a slightly increased inflation trend. Consumer financial positions are currently good, with the installment debt-to-income ratio at its cyclical low, leaving room for more financing. Lastly, consumer confidence has been increasing, buoyed by continued declines in unemployment and interest rates. The level of confidence moderated somewhat as interest rates moved up over the summer but recovered in the fall. The pace of the gains is not likely to be sustained over 1984, however, if interest rates are unsettled.

Table 1
Real Growth Rates of Consumer Spending During Mid-Recovery, Current versus 1975/76
6-month Average Rate

Item	1975:4-1976:2	1983:3-1984:1
Cyclically Sensitive Categories		
Motor vehicles & parts	19	13
Furniture & appliances	4	7
Other durables	6	9
Clothing & shoes	3	5
Fuel	25	4
Cyclically Insensitive Categories		
Food	8	3
Gasoline	8	-3
Other nondurables	3	5
Electricity	4	1
Transportation	-6	-2
Housing	5	3

Source: Data Resources Incorporated

The outlook for 1984 is one of continued steady increases in consumption expenditures. The expected increases in disposable income, coupled with a saving rate around 5 percent, would allow real expenditures to grow at about 4 to 4.5 percent for 1984. The emphasis will continue to be in durables, with substantial real growth in autos and in housing-related purchases of furniture and appliances. Nondurables, which are cyclically insensitive, are expected to show more modest gains.

Employment

The strong rebound in consumer spending promoted a surge in industrial production that in turn led to steady improvement in the employment picture in 1983. The employment gains during the recovery mirrored the production patterns. Growth in the first quarter was concentrated in interest-rate sensitive sectors, especially durables manufacturing. Nondurables manufacturing showed smaller gains; the employment in the services sector increased steadily. Because the total gains were slightly larger than the increase in the labor force, the unemployment rate decreased somewhat, dropping from 10.7 percent in the fourth quarter of 1982 to 10.4 percent in the first quarter.

Over the summer, employment gains remained strong. Because of large labor force increases, however, the unemployment rate declined only slightly from the first quarter, falling 0.3 percent. Further employment gains were expected to bring the unemployment rate below 9 percent by yearend.

Employment will continue to expand in 1984 as the recovery continues. Manufacturing employment will continue to rise at about a 5 percent rate and overall employment at a somewhat slower rate, 3 to 3.5 percent. The employment growth, taken with

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a slower expected growth in the labor force, suggests a gradual decline of around 0.2 to 0.3 percent per quarter in the unemployment rate, with the rate near 7.5 percent by yearend.

Business Expenditures

Inventory and Production

After sharp inventory reductions in the fourth quarter of 1982, demand began to pick up in the first quarter providing business an incentive to slow inventory liquidation. Production increases were substantial in the interest-sensitive consumer goods, most notably autos, housing, and housing-related goods. Feedstock industries to housing and autos—primary metals and lumber—also began to show signs of improvement.

With the rebound in consumer spending, industrial production began an earnest upward move in March, surging 20 percent (annual rate) in April, the largest monthly gain since August 1975, and climbing again in May. Production gains were broad-based in the second quarter, although the auto and housing industries continued to lead. The strength of the consumer rebound caught businesses off guard, producing substantial net inventory reductions during the first quarter and small reductions during the second quarter, even though the rate of production was increasing.

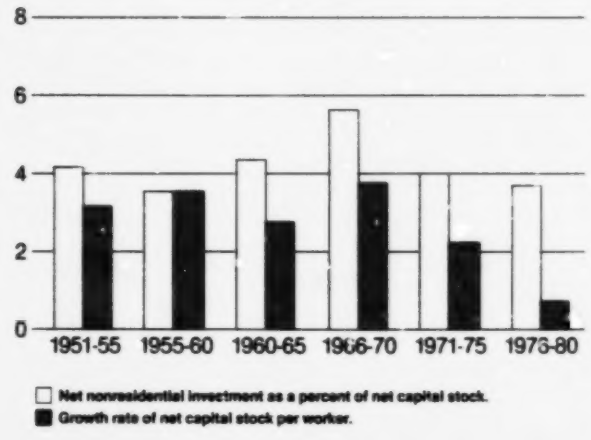
The slowdown in consumer spending over the summer ensured the building of some inventory over the third quarter, as well as a concomitant slowdown in production, especially of finished goods. The rebuilding of inventories of intermediate goods and materials was expected to continue into the fourth quarter. Inventory build-up, relative to the more moderate consumer spending growth, should be completed during the first half of 1984. Given the relatively steady growth foreseen for consumer demand over 1984, inventory levels are not likely to see much movement beyond mid-year. Production growth is likely to move in line with growth in demand.

Investment

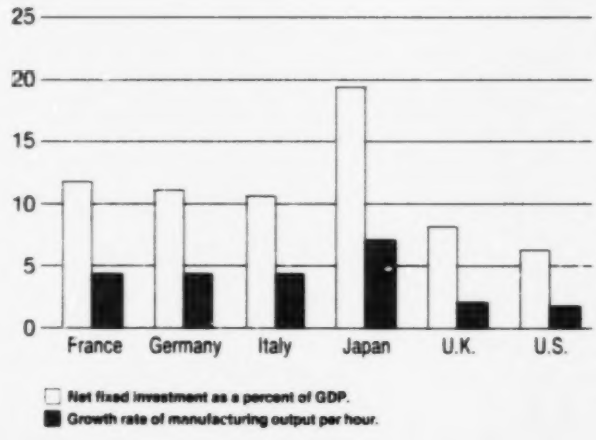
The capital goods investment sector has begun a recovery. The second quarter saw a 4.5 percent gain over the first quarter in producers' durable equipment, traditionally a close follower of production patterns. Office and store equipment led the way, reflecting the penetration of computers, word processors, and other electronic equipment. Equipment spending posted a broad-based 3.7 percent gain in the third quarter as production continued strong.

The recovery in equipment spending and expectations for continued improvement can be traced to several factors. The growth in sales, accompanied by the low inventory stocks and strong productivity gains typical of early recovery periods, has dramatically boosted profits. Corporate profits (with inventory valuation and depreciation adjustments) rose 12 percent in the first quarter and increased another 20 percent in the second quarter. In addition, capacity utilization rates, spurred by the gains in production, have climbed steadily for most industries during 1983; overall capacity use was expected to be near 80 percent by yearend. Finally, capital goods prices have shown only a moderate degree of inflation. Conditions are thus in place for continued expansion in investment activity in 1984.

Trends in Capital Formation
Percent of Capital Stock & Growth Rate



Comparison of Capital Formation, 1971-80
Percent of GDP & Growth Rate



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Long-lived capital investments, such as nonresidential structures, generally lag the business cycle by about a year. The lag may be longer in this cycle. Existing data suggest little improvement before mid-1984, with contracting for commercial and industrial building remaining around its current low level through the first quarter of 1984. While retail building has already shown some recovery, office construction is declining and will continue to do so until at least 1985, reflecting the current glut in the office building market.

Housing

True to its position in the business cycle, residential housing began to recover in early 1982 when interest rates started moving down. Following the break in interest rates in the third quarter of 1982, housing starts accelerated rapidly in the fourth quarter, hitting 1.3 million starts (annual rate). But the extent of pent-up demand began to reveal itself in 1983 when first quarter starts surged to 1.7 million units.

Second-quarter starts were about the same as first-quarter levels, even though interest rates began to move up in May. Starts continued strong over the summer with multi-family units gaining and single-family units tapering off following the rise in mortgage rates. The multi-family starts appeared to represent some degree of overbuilding. Thus, the summer's starts were seen as unsustainably high. Housing starts for the year were expected to be 1.65 to 1.7 million units.

The outlook for 1984 is for some modest growth in starts over 1983, with starts reaching 1.7 to 1.75 million units. The demographic pressure of the maturing baby-boom generation will continue to be felt. The continuing economic expansion will prompt personal income rises and declines in unemployment. Consumer balance sheets are currently in good condition, able to take on additional debt. Mortgage rates may remain around current levels over much of 1984 as savings and loan institutions should be able to supply increased financing for new mortgages, provided that business investment demand does not expand significantly before the end of 1984, pushing up rates.

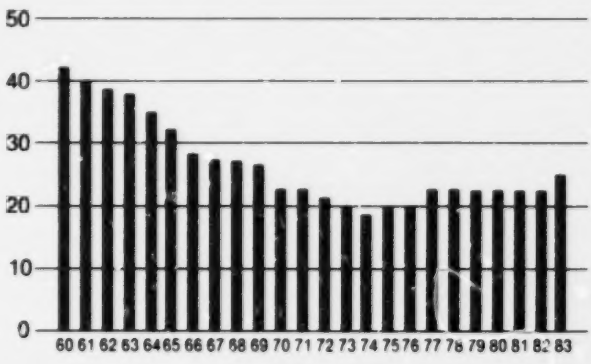
Because there is a lag of about 6 months between starts and units under construction, construction surged during the second half of 1983. Bottlenecks appeared and materials prices, especially lumber (which accounts for about one-sixth of the selling price of an average house), responded. Last spring's surge in lumber prices reflected the twin pressures of insufficient inventories and gearing-up problems in the industry. Future price increases will be moderate; thus, overall new housing prices for 1984 are likely to be up a little faster than inflation, with the increases ranging between 6 and 8 percent.

The Public Sector

After considerable effort, in June Congress adopted the First Concurrent Resolution on the Budget for fiscal year 1984, revising the budget limits for FY 1983 and setting revenue and spending targets for 1984-86. Under the plan, the budget deficit was projected to decline from $180 billion for 1984 to about $131 billion for 1986 (Congressional Budget Office estimates). The improvement was expected to come mainly from higher revenue growth. The rise in revenues would be the result of the economic recovery, the enactment of the Social Security Amendments of 1983, which incorporate future payroll tax increases to finance social security benefits, and tax legislation to increase revenues by a total of $73 billion over the 1984-86 period, with $46 billion of this increase coming in 1986. The proposed tax legislation constituted the major part of the deficit reduction. The Resolution also provided for a $20 billion "reserve fund" for several domestic spending initiatives to be released upon enactment of authorizing legislation.

The major sources of spending growth under the Resolution were defense, entitlements, and interest on the Federal debt. Almost half the spending increase under the Resolution was for national defense; a 5 percent real growth in budget authority for 1984-86 was provided. Entitlements and mandatory spending—Social Security, Medicare and Medicaid, unemployment benefits, and Federal employment retirement benefits—accounted for one-fourth of the projected outlay growth. Net interest payments on Federal debt,

Federal Debt
Percent of Gross National Product



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projected to rise more than 40 percent from 1983 to 1986, constituted the third major source of growth.

In July 1983, the Administration presented its mid-session review of the budget. The review outlined revenue and outlay growth that would produce deficits of $180 billion for FY 1984 and 1985, and $145 billion by FY 1986 (Congressional Budget Office estimates). Greater spending reductions and somewhat smaller tax increases, especially in 1984 and 1985, constituted the major dollar differences from the plan proposed by Congress. More striking were the differences in composition of spending changes. The President proposed significantly higher levels of defense spending, with a real rate of growth near 10 percent, and much lower levels of spending for domestic programs. Under the President's proposals, outlays for defense would exceed the Resolution level by $43 billion over the whole 1984-86 period, while outlays for nondefense programs would be $58-75 billion lower. There were no domestic spending initiatives (such as were in the reserve fund), and there were sharper cuts in Medicare and other current domestic programs.

Before adjournment last year, the 98th Congress passed a compromise $250 billion defense appropriations bill, preserving almost all of the major defense programs outlined by the President for the next 3 fiscal years. The appropriation represents a real increase estimated by the CBO at 2-3 percent over the appropriation for FY 1983.

Outlook for 1984

The Congress probably will not approve the majority of the tax increases for FY 1984-86 assumed in both the President's budget and the June Resolution. Consequently, the budget deficits are expected to be about $190 billion for each of the next 3 fiscal years. These estimates assume that Congress will approve the $12 billion in spending cuts contained in the Resolution and a tax increase of around $5 billion.

Before adjournment the House had approved $10.3 billion of the spending cuts, but the Senate postponed consideration of a companion measure until this year. None of the several tax bills proposed in 1983 were approved by the Senate.

The extraordinarily high deficits represent the culmination of rapid growth in Government expenditures at an annual average rate of over 13 percent for the last 4 years, as compared to an annual average growth rate of 8 percent for the economy. Discontinuing this trend, which is critical to reducing the size of the budget, hinges upon the adoption of more austere fiscal policy measures that are compatible with the current policy of the Federal Reserve System. However, expectations for adoption of such a policy in 1984 are not encouraging.

Foreign Trade

The U.S. trade position continued to deteriorate in 1983 in the face of the world recession and the loss of competitiveness brought on by the strong dollar. The merchandise trade deficit held steady at about $3.6 billion per month (NIA basis) for the first quarter, but increased sharply in April to $4.6 billion as oil imports rose and exports of manufactured goods fell sharply. Exports continued to slide in May, while imports of oil and autos continued to rise, resulting in a record $6.9 billion deficit. The summer saw a continuation of the red ink, with average monthly deficits of around $6 billion. Imports of oil and a variety of industrial products and machinery advanced during this period, while agricultural exports held steady and exports of manufactured products fell. Given the relatively strong performance of the U.S. economy, the sluggish economies of our trading partners, and the strength of the dollar, the imbalance between exports and imports was expected to continue and to produce a trade deficit of around $55-60 billion for the year, up sharply from $35 billion in 1982.

On the services side, the flows declined by over $14 billion between the peak in the spring of 1982 and the first quarter of 1983, reflecting declines in interest flows from overseas loans. However, service imports also fell by $11 billion as tourism abroad and other service imports shrank, victims of the U.S. recession. Thus, the net service surplus declined by around $4 billion over this period. As a result, the balance on current account (the sum of the net merchandise and net service accounts plus statistical errors) recorded a first quarter deficit of about $3 billion. The continued deterioration of the

Table 2
U.S. Commodity Trade Balances, 1973 and First Half 1981 and 1983*
$ Billion Seasonally Adjusted Annual Rates

Item	1973	First half 1981	First half 1983
Agricultural goods	9	28	18
Capital goods & chemicals	17	60	40
Fuels	-7	-77	-42
Automotive products	-4	-10	-22
Other**	-14	-24	-41
Overall Trade Balance	**1**	**-24**	**-47**
Current Account Balance	7	8	-27

*Commodity balances are exports less imports.
**Other is mainly consumer goods.

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service surplus, combined with sharp increases in the merchandise trade deficit, increased the current account deficit to nearly $10 billion in the second quarter. The current account deficit was expected to stabilize in the vicinity of $10-12 billion for each of the two remaining quarters, which would bring the total deficit for 1983 to $35-40 billion.

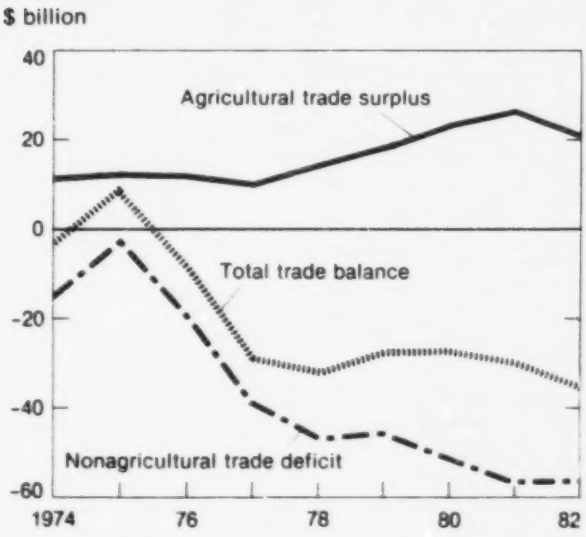
The decline in the U.S. trade balance is generally related to 3 factors: (1) the appreciation of the dollar against the currencies of other industrial countries; (2) the financing problems and consequent adjustment measures of some of the developing countries; and (3) the continuing weakness in the recoveries of the various foreign economies.

1. The Strength of the Dollar—The value of the dollar has risen sharply relative to most other major currencies since 1980. It appreciated by 46 percent against a weighted average of the currencies of the other major industrial countries from the second half of 1980 to the first half of 1983. The dollar continued its ascent over the summer of 1983, but weakened somewhat in the third quarter as U.S. interest rates edged lower. For the balance of the year, it was expected to hold fairly steady.

Several factors influence the dollar's value. The sharp drop in U.S. inflation relative to that in many foreign economies since the late 1970s has contributed substantially to the rise of the dollar. Real interest rates have been higher in the U.S. than in other major industrial economies since 1980, making the U.S. financial markets the target of large capital inflows. The dollar has been strengthened by the relatively faster real growth of the U.S. economy and the perception of the U.S. as a "safe haven" for investment. The recent size of the trade deficit has not been strong enough to outweigh the effects of the other factors. Since the abandonment of fixed parities, innovations in and integration of the world capital flows have made capital investment preferences the principal determinant of currency values. Thus, the current account follows, rather than leads, capital trends; a current account deficit will not necessarily bring the dollar down, as long as investors prefer to acquire dollar-denominated assets.

The dollar is likely to continue to show strength in 1984. Large current and prospective U.S. budget deficits, together with increasing private credit demands, will put upward pressure on real interest rates. Further appreciation in the dollar is likely against the higher inflation European currencies. Continuing weakness in the Latin American

U.S. Trade Balance



economies will almost surely result in the dollar showing strength against these currencies. The dollar may drift lower against the German, Canadian, and Japanese currencies even as it maintains strength elsewhere. The recoveries in these countries are strong; they are expected to show strong current account surpluses, and their central banks have been keeping monetary policy tight, which has held down the real interest rate differentials between their currencies and the dollar.

2. Foreign Debt—A second cloud on the horizon for U.S. exports is the debt crisis in the developing countries. In 1982, the non-Communist developing countries purchased 39 percent of U.S. merchandise exports; however, in 1983, their share dropped to 36 percent. Exports to Latin America during January-May 1983 plunged 35 percent from the same period a year ago, as Mexico, Venezuela, Brazil, and Argentina sharply curtailed imports. In contrast, exports to the East Asian developing countries increased in the first 5 months of 1983.

The problem began as the developing countries tried to finance growth. The expectations of continued growth in industrialized world demand for their exports provided the incentive to borrow to develop the capacity to keep up with that demand. Low interest rates and the high inflation rates of the 1970s made borrowing a sound economic strategy, as earnings from development projects more than covered the costs of the loans. Thus, the growth in credit use contributed to more development, which raised the creditworthiness of many nations and opened up the channels for borrowing from commercial lenders. When the recession hit,

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however, their exports dropped and the value of the dollar climbed relative to the values of their currencies. Consequently, many reached the point at which they could no longer keep up with loan repayments, and reschedulings were negotiated. Although the global debt crisis has eased with the rescheduling of loans, it is still real, with serious problems in those nations so deeply in debt that income from export sales is insufficient to service their debt. Brazil, Venezuela, Argentina, and Chile are among those countries in jeopardy. With the exception of the Philippines, the drain of debt service on export income is manageable in most East Asian countries.

The debt crisis has serious implications for U.S. exports. The nations in trouble have had to scale back or abandon economic development projects that depended on imports. Agricultural imports were usually the first to decline, as they do not add to potential export earnings. The value of U.S. agricultural exports to all developing nations declined 16 percent from fiscal 1981 to 1982; in the same period, U.S. exports to those developing nations requiring debt rescheduling fell 32 percent.

3. The World Economy—The outlook for the developing countries is clouded. As the economic recovery spreads abroad, volume and prices for the export products of these countries should improve in 1984. This would increase credit availability, which would help to feed renewed economic growth and trade expansion. Thus, the very slow growth projected for the Latin American economies in 1984 would be followed by slightly stronger growth the following year.

Table 3
Real GNP Growth Rates for Selected Regions or Countries, 1981-1984
Percent Change

Country or Region	1981	1982	1983'	1984'
Europe (France, Germany, Italy, U.K.)	-0.3	0.4	0.6	2.0
Latin America	2.0	-1.2	-2.3	1.6
East Asia	7.6	3.9	4.0	6.1
Japan	3.9	3.0	3.3	4.2

' = DRI forecast

The outlook for world economies in general is for moderate growth in 1984 and 1985. Expansions are under way in Canada, Japan, Germany, Great Britain, and East Asia, although the prospects for upturns in France and Italy remain uncertain.

The Outlook for U.S. Trade
The continuing strength of the U.S. recovery versus the relatively weaker recoveries of our trading partners and the continued strength of the dollar suggest that the U.S. trade deficit will grow much larger in 1984. With imports continuing to outpace exports, the trade deficit is expected to rise to around $75 billion. Rising imports of autos, textiles, and electronics will be responsible for most of the increase. Imports of computers, communications equipment, and machine tools are increasing as U.S. companies continue to lose their competitive edge in these capital goods. Net energy imports, down in 1983 as oil prices declined, are likely to rise as the U.S. recovery continues.

Inflation

Low levels of inflation characterized the first half of 1983. Consumer prices rose at an annual rate of less than 3 percent during this period, the Producer Price Index for intermediate goods fell 2.7 percent (annual rate) from December to June, and the fixed-weighted GNP deflator rose at a 4.3 percent annual rate in the first half of the year. Advances more typical of a strong recovery were recorded over the third quarter, however, with the PPI for intermediate goods rising at an annual rate of 6 percent.

The slow growth of prices reflects three factors: (1) much slower wage growth combined with robust productivity gains typical of the early stages of economic recoveries; (2) lower commodity prices, particularly oil; and (3) the strong dollar, which has cut the cost of imports and forced margins down in U.S. industries that compete in foreign markets.

1. Wage Growth—Wage gains continued to slow in the first half of 1983 as the unemployment rate remained in the double-digit range. Overall hourly earnings (including overtime) advanced 4.6 percent over the 12 months ended in June, versus 6.0 for the 12 months ended in December 1982. Wages were expected to increase somewhat faster in the latter half of 1983, bringing the hourly earnings increase to around 4.8 percent for the year. The slight acceleration will continue in 1984, with hourly earnings increasing at a 5 percent annual rate. The still-high unemployment rate will prevent faster gains.

2. Commodity Prices—Commodity prices have passed through a period of slow growth, with the Producer Price Index for intermediate materials expected to advance less than 3 percent during 1983. As the economy continues to expand in 1984, demand pressures will gradually resurface with price

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patterns reflecting the cyclical nature of the industry. The PPI for intermediate goods will grow by around 5.5 percent during 1984.

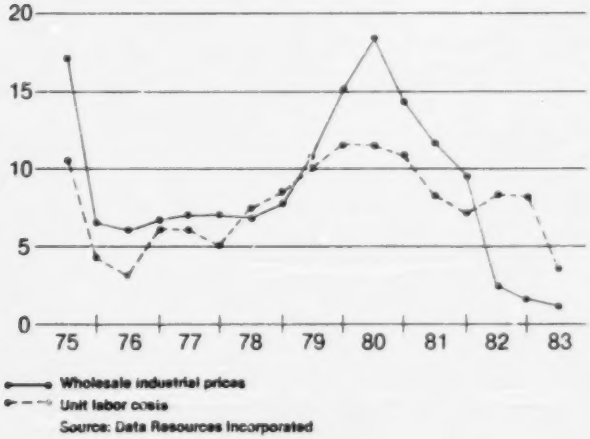
World oil prices dropped sharply in early 1983, as the decline in the demand for oil products during the recession left distributors with excess inventories. The final agreement reached in March by the OPEC oil producers resulted in a formal reallocation of production, coupled with a cut in the price of Saudi crude to $29 per barrel. Since April, prices of crude have risen somewhat as U.S. oil imports revived. The 5-cents-per-gallon federal gasoline tax has added to the price increases felt by the consumer. Prices for 1984 are expected to show stability. The weakness of the world recovery, together with the wide margin of underutilized OPEC capacity, will forestall any sharp increases.

The Outlook for Inflation

The moderation in wage growth, coupled with sharp productivity gains, has combined to bring about a decline in unit labor cost growth to less than 3 percent in 1983 (from 9 percent during the 1979–82 period). With moderate wage gains in 1984 and continued labor productivity gains, the growth in unit labor cost will be of the same order—around 3.5 percent. The growth foreseen in materials prices, together with the modest growth in unit labor cost, indicates a moderate rise in inflation for 1984, probably around 5 to 5.5 percent in the CPI.

Cyclical Patterns of Costs

Year-over-year Percent Change



Source: Data Resources Incorporated

Interest Rates

Interest rates during 1983 moved relatively little from levels prevailing at the end of 1982. Providing stability to interest rates was the monetary policy employed by the Federal Reserve. Following its latest discount-rate cut in December 1982, the Fed maintained a fairly constant degree of reserve restraint until May. At that time, it became clear that the excessive money-supply growth during the previous 9 months was being transformed into a more-than-moderate economic recovery. Credit market participants doubted that economic policymakers could shape a more-than-moderate recovery without creating excessive inflation and heightened credit demands. In anticipation of these developments, interest rates began to drift higher. At its May meeting, the Federal Open Market Committee did in fact vote to embark on a slightly more restrictive policy. This action was taken in the interest of arresting money-supply growth without causing interest rates to move so high as to abort the economic recovery or create added debt repayment problems for foreign countries. The policy subsequently appeared successful in that both money-supply growth and economic growth moderated in the second half of 1983, with interest rates declining from their peaks established in early August.

The fundamental factors underlying the interest rate outlook line up as follows. First, monetary policy is not likely to deviate significantly from the last half of 1983. The reserve policy pursued since May 1983 should allow money-supply growth to track within the Fed's indicated 1984 targets of 4 to 8 percent, 6½ to 9½ percent, and 6 to 9 percent for M1, M2, and M3, respectively. These target ranges appear consistent with expected real economic growth of 4.5 to 5 percent, assuming that growth in monetary velocity in 1984 does not shoot significantly above its trend rate of growth over the last 10 years and that inflation in 1984 is limited to around 5 percent.

Second, the continuing debt problems of the developing countries will put pressure on the Federal Reserve not to tighten monetary policy. Much of foreign debt service costs are linked to U.S. rates, and their debt is denominated in dollars. Thus, increases in U.S. rates push up the real resources that must be given up by the developing countries to service their debt. Such additional costs place great burdens on those countries already experiencing difficulty in negotiating new credits or rolling over existing ones.

Finally, the demand for credit in 1984 is not expected to exceed the supply. If the Federal Reserve keeps to its target range of about 8 to 11 percent for growth of total domestic nonfinancial credit in 1984, total funds available in the credit markets would be projected to run about $450 to $600

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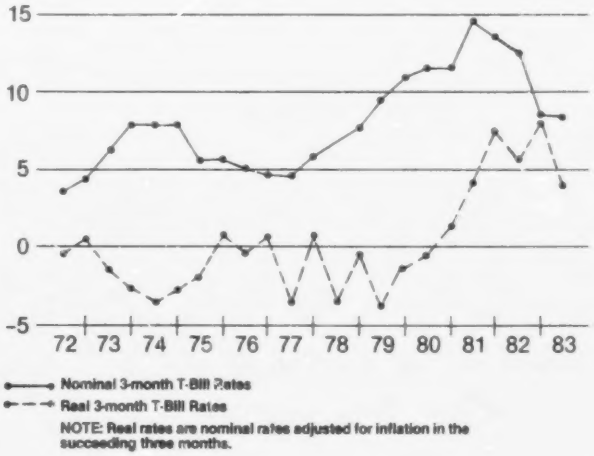
billion. Total public borrowings for 1984 are expected to be around $250 billion, leaving private-sector borrowers with about $200 to $350 billion. A credit demand of $350 billion by the private sector would represent a moderate increase of about 9 to 10 percent over 1983 borrowing, a growth typical of private borrowing in the second year of a recovery. Thus, it appears that the huge credit needs of the Federal Government will not "crowd out" the still-weak needs of the private sector in 1984. The clash between projected public and private needs may come in 1985, as the growth of private demand typically increases in the third year of a recovery.

Selected Interest Rate Measures
Nominal and Real Interest Rates



NOTE: Real rates are nominal rates adjusted for inflation in the succeeding three months.

The Outlook for Rates

Short-term interest rates during 1984, when averaged over the entire year, are expected to decline from the average levels prevailing during all of 1983 to levels resembling those observed during the first 6 months of 1983. Average long-term rates, on the other hand, are likely to be slightly higher than during all of 1983, as businesses are expected to redirect their borrowing activity towards longer dated liabilities. Such an action will be motivated by the need for corporations to match-fund an increase in capital expenditures. This activity, along with the Treasury's propensity to extend the average life of the public debt, will push the spread between short- and long-term yields to levels normally seen during an economic recovery.

The following table compares expected 1984 average interest rates with approximate averages for 1983:

	1983	1984
Overnight federal funds	9.1	8.5
3-month Commercial paper, bank discount basis	8.9	8.3
6-month Treasuries, auction—bank discount basis	8.7	8.1
1-year Treasuries, auction—bank discount basis	8.8	8.2
3-to-7-year Treasuries, constant maturities	10.7	10.7
10-to-20 year Treasuries, constant maturities	11.2	11.5

Short-term rates may edge lower over the first part of 1984 as the expansion moderates. However, both short- and long-term rates are expected to drift upward later in the year, as the credit markets anticipate the possibility of a clash between public and private-sector borrowing in 1985.

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II. AGRICULTURAL ECONOMIC OUTLOOK

Hastily introduced farm program changes last January followed by a severe drought combined to drastically modify conditions in the farm economy from what appeared solidified just a year ago. As dramatic as the reversal in stocks and prices of feedstuffs has been, 1984 could easily see a return to burdensome stock levels. Record feed grain acreages are likely to return, subsoil moisture has been largely recharged, domestic livestock producers will be even more cautious in their production decisions, and world agricultural trade has little prospect for rapid expansion.

The past year brought a significant shift in the plights and fortunes within the domestic farm economy, as well as a further loss in our competitiveness in world markets. At the same time, these adjustments have meant fairly minimal impacts on our domestic consumers and foreign stomers because of the large meat and cereal su plies still on hand here and abroad. A retrospective look at 1983 provides an overview of how the fortunes of many involved in the agricultural economy took widely divergent paths.

As 1983 began, the United States had become deeply entrenched as the carrier of global grain supplies. Those large supplies, coupled with weak demand, meant that livestock producers were facing a better price/cost outlook than crop producers. While prices were low and income prospects poor, crop producers were not quickly embracing the set of farm programs in place for 1983. More economizing on input usage was expected. Yet agribusinesses had just provided the goods and services associated with back-to-back record-breaking crops. Thus, input suppliers, including lenders, were gearing themselves for only modest declines in volume and an increased need to monitor the financial condition of their customers. And USDA's Commodity Credit Corporation not only found itself with costly inventories and storage payments for farmer-owned reserves, but saw itself soon acquiring huge quantities of commodities in lieu of loan repayments, with no foreseeable market outlet for these stocks.

Although the introduction of the Payment-in-Kind (PIK) program in January was greeted with considerable skepticism, it soon embodied a new psychology in many rural areas. Suppliers were among the first to feel the wheels of fortune turning; many with large inventories faced losses from sharply reduced market demand and lower prices. Declining land markets began to reverse in many areas; the rental market in particular picked up as farmers searched for other acres on which to use their equipment. The winter wheat crop had come through winter in excellent condition, and good subsoil moisture in most areas portended promising yields for the spring and summer crops. Prices of the program crops began to advance prior to the signup news of late March; however, large stocks being carried out of the 1982/83 season and prospective 1983 yields at or above trend suggested that the potential for significant price advances would first come in 1984 with a second year of PIK.

The unexpectedly large signup, particularly in the corn/sorghum program, sustained the unsettled price situation during the spring quarter. Firm feed grain prices put downward pressure on hog margins and caused cattle feeders to think in terms of grass rather than feedlots. Crop prospects, as well as pasture and range conditions, were good to excellent into early July with few areas showing either near- or long-term moisture problems. Up to that point, most areas were rated as being somewhat above normal for subsoil moisture. The exceptionally good early prospects probably led some producers who had signed up for only the voluntary acreage reduction/paid diversion program to back out in favor of all-out production. And those prospects, coupled with the PIK program's removal of less-productive acres, probably led to the significant decline in producer participation in the Federal Crop Insurance Corporation's program.

Crop and pasture conditions rapidly deteriorated during July and August as hot, dry weather affected nearly all areas other than the West Coast, the Gulf Coast, and the northern fringe of the Corn Belt. By September, livestock producers had seen a dramatic reversal in their cost-price and feed availability situation. At the other extreme were crop producers, many of whom had begun the year thinking that the Government's loan program was the only viable market strategy available. By midyear, at least some producers were seeing the reemergence of market-clearing prices.

Even the Government felt a significant turnabout in its situation. Rather than acquiring commodities through forfeiture of loans, the CCC found many producers able to repay their loans directly, such that the Government had to scramble to find ways

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to meet its commitments for the PIK program. Policymakers found that even their most ambitious plans for diverting acres to achieve desired supplies were no match against the forces of nature. Record wheat yields mitigated that program's affect, but drought more than doubled the adjustment in feed grain and soybean stocks expected from the acreage reductions alone.

Farm Income and Expenses

Contrary as it may seem, the short crops of 1983 have generated an improved net income situation for the farm sector as a whole. The sector often prospers when supplies tighten, because farm prices tend to rise proportionately more than production drops. This yields a higher level of gross income than would have existed otherwise. Benefits, of course, are not shared uniformly—certain geographic areas tend to gain at the expense of others, and livestock producers are often forced into unplanned adjustments. High participation in the 1983 farm programs is currently mitigating the regional differences caused by last summer's drought but amplifying the income extremes among neighboring farmers. This diverse income situation is examined more closely in the following chapter where we treat the financial status of borrowers.

Interpretation of the Net Income Measures

As 1983 was drawing to a close, each of the major net farm income measures was expected to register an increase—from as small as $2 billion for total net to as much as $10 billion for realized net—over that in calendar 1982. The gains were mainly coming from a drop in cash expenses associated with the acreage-reduction programs and from a large drawdown of crop inventories. Total cash income from farming was expected to grow by $3 to $4 billion, with a sharp increase in Government payments (mainly PIK) offsetting a small drop in cash receipts from new crop marketings. The outlook for farm income measures in 1984 is mixed; the likely course is for another gain in total net, but for sizable declines in realized net and net cash income. (USDA planned to release specific 1984 forecast ranges in December after our printing deadline.)

In addition to one major unknown involved in yearend farm income forecasts—how much of the new crop is sold in the current year versus being held for the next year—a second and perhaps more critical unknown existed at the end of 1983. The eventual levels of the various net income measures for both 1983 and 1984 will be significantly influenced by when farmers elect to receive their PIK commodities. Tax considerations plus pricing prospects are keys to an individual farmer's decisions about the timing of marketings and acceptance of PIK entitlements. (Information needed to make the estimates becomes available with a considerable lag time.)

These two unknowns affect the net farm income measures differently, and this gives rise to the mixed expectations for 1984. Whereas harvested crops show up in the income accounts as either having been consumed, sold, or in inventory, Government payments appear only once—at the time of disbursement. The payments-in-kind being received by farmers are considered to be Government payments, because the income accounts treated the original CCC loans as cash receipts (sales to the Government). Thus, the PIK quantities are not being included in inventories for farm income accounting purposes.

Total net farm income, which takes into account whether inventories are being physically accumulated or depleted, is affected very little by the marketing pattern, but directly by the timing of Government payments. Both aspects directly

Table 4
Farm Sector Income and Cash Flow Statement, 1979-1983*
$ Billion

Farm Income Sources	1979	1980	1981	1982	1983[1]
Crop receipts	63.2	72.7	73.1	74.4	72±2
Livestock receipts	68.6	67.8	69.2	70.2	70±1
Government payments	1.4	1.3	1.9	3.5	9±1
Other cash income	1.6	1.6	2.0	2.1	2
1 Total cash income	**134.7**	**143.4**	**146.2**	**150.1**	**154±1**
Nonmoney income	10.7	12.1	13.3	13.9	14
2 Value of inventory change	4.9	-5.3	7.6	-1.9	-7±1
3 Total gross income	**150.4**	**150.1**	**167.1**	**162.2**	**161±1**
Production Expenses					
4 Cash expenses	97.3	105.3	111.5	113.8	110±1
5 Total expenses	**118.1**	**128.6**	**137.0**	**140.1**	**136±1**
Income Measures					
6 Net cash income (item 1 − 4)	37.4	38.1	34.7	36.3	44±2
Realized net (3 − 2 − 5)	27.3	26.8	22.4	23.9	32±2
Total net (3 − 5)	32.3	21.5	30.1	22.1	25±1
Off-farm income	35.3	37.7	39.9	39.4	41±1
Other Sources & Uses of Funds					
7 Change in real estate loans	13.0	9.4	9.0	3.7	3±1
8 Change in nonreal estate loans	10.9	5.9	6.2	3.1	4±2
9 Rental income	5.6	5.6	5.7	5.0	5±1
10 Gross cash flow (6 + 7 + 8 + 9)	66.9	58.9	55.6	48.0	50±3
11 Capital expenditures	19.9	18.0	16.8	13.9	14±2
Net cash flow (10 − 11)	47.0	40.9	39.0	34.1	35±2

*Adapted from page 12 of USDA's August 1983 Agricultural Outlook.
[1] Forecast.

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relate to the other net measures that are not concerned with how much income is generated by the output in a given period, but rather with how much income farmers elect to receive or realize during a given period. The upshot of this discussion is that USDA's 1983 total net farm income measure will significantly understate the income generated during the calendar year. Instead, a sizable part of the earnings generated through farmers' participation in the 1983 program ($3 to $4 billion) will be credited as being generated during 1984. Rarely, if ever, has the method of treating Government payments given rise to the magnitude of year-to-year distortion in the total net farm income series that will be seen from 1982 to 1984—as much as $8 billion between 1983 and 1984. This will also disrupt the usual pattern of relative fluctuations among the several net income measures across these years.

Of the several net income measures, total net tends to have the largest year-to-year fluctuations. It reflects best the ups and downs in the earnings that the sector generates. The other measures are better at reflecting how farmers, and particularly crop producers, are able to manage their inventories to meet cash flow needs, price objectives, or a leveling of taxable incomes. The net cash series is the one most reflective of farmers' ability to manage their cash flow through both input-purchasing and product-marketing decisions—the result is a series tending to have the least overall variation. Taken separately, the various measures often tell different or conflicting stories; when viewed as a group, they can convey a meaningful picture of how the sector is managing its earnings and reserves.

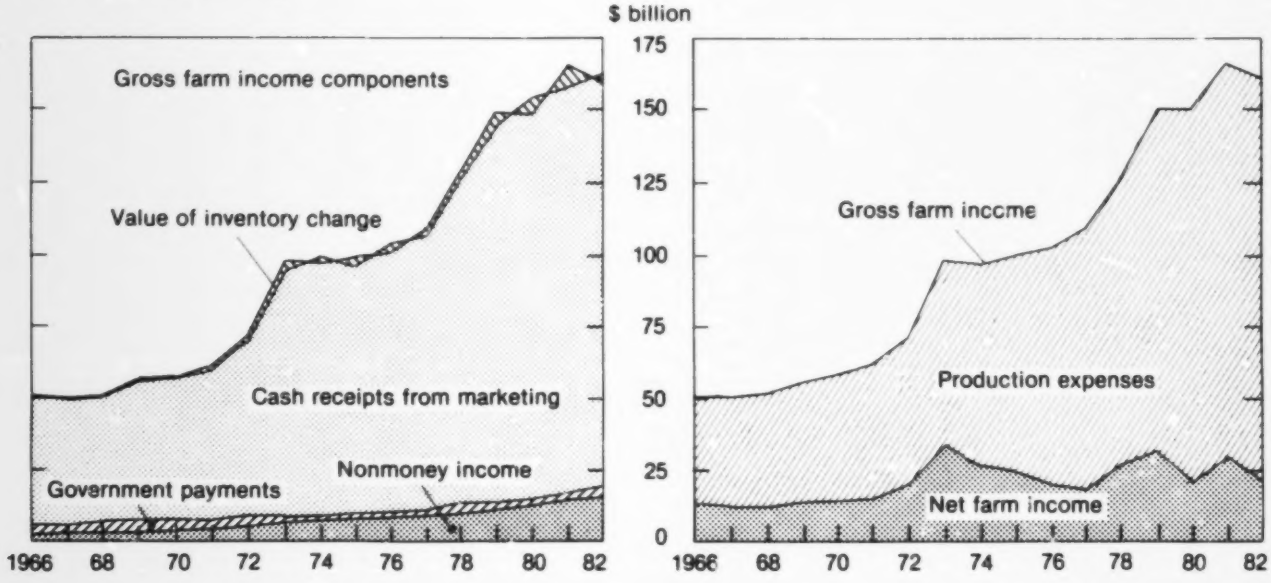
Review of Production Expense Pressures

Revised farm income estimates for 1979–82 (released in August 1983) show that the farm sector had a less serious net income and cash flow problem than the initial set of estimates had suggested. The new figures, which mainly involve lower production expense estimates, still reveal that there was a tightening cash flow, with expenses tending to rise faster than receipts. Credit quality data from agricultural lenders have shown over the past 2 years a small but growing group of farmers in serious financial difficulty, and there were concerns that a much larger group may have been bordering on repayment problems.

While the extent of serious problems may be less widespread than feared, it is clear that heavily indebted farmers were among the first to feel the cash flow squeeze. Indeed, an $8.5-billion increase in interest outlays accounts for fully half the overall increase in cash expenses from 1979 to 1982. Were it not for the rise in interest expenses, net cash income would have risen 20 percent between 1979 and 1982, rather than dipping as it did.

The debt-service burdens and cost of credit have been on the rise for several decades, with the most dramatic increases occurring during the past decade. During 1982, interest accounted for $21 billion or 18.4 percent of the $113.8 billion in cash

Income from Farming



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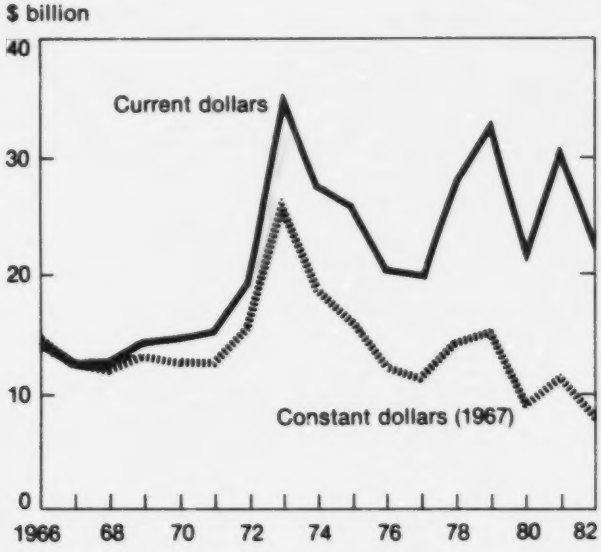
expenses, and nearly $22 billion or 15.6 percent of the $140.1 billion in total expenses. Ten years ago, interest expenses were only about $4.5 billion and accounted for 8 percent of cash expenses and 7.2 percent of total production expenses.

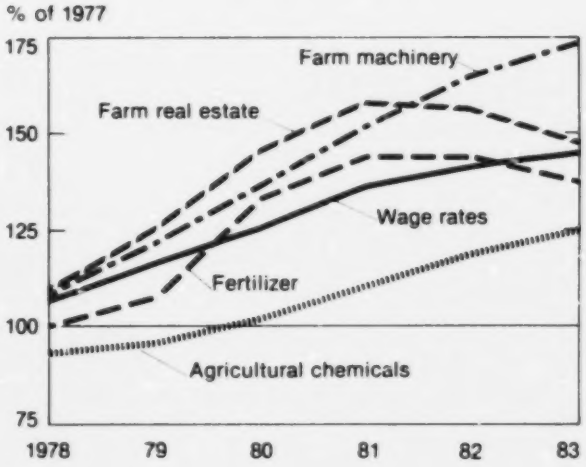
The 1983 acreage-reduction programs finally reversed the inexorable upward trend in farm production expenses. However, the benefits were entirely associated with the crop sector; livestock producers found sharply higher feed expenses. Uses of the major manufactured inputs—fertilizers, fuel, and pesticides—are estimated to have dropped from 9 to 14 percent. These large declines were the primary cause of the first drop in overall production expenses since 1953. Price pressures were moderate for a second consecutive year, largely because of the low level of inflation in the general economy and because of the reduced demand for farm inputs.

Production expenses will rebound sharply in 1984 as farmers return much of their 1983 idled acres to field crops and as input prices move up somewhat faster in concert with an anticipated increase in the rate of inflation. Farmers are expected to spend 15 to 20 percent more than in 1983 for pesticides, fertilizers, farm machinery (including repairs), and energy. Typically, these items account for around one-third of total expenditures for crop and livestock production. Farm demand for pesticides, especially herbicides, will climb substantially as row-crop production returns to what, in many instances, was weed-infested conservation acres.

Net Farm Income



Prices of Selected Farm Inputs



1982 preliminary, 1983 projected. Farm machinery includes tractors and self-propelled machinery.

Because of a substantial drop in capital expenditures the last 2 years, depreciation expenses in the income accounts are expected to drop 1 to 3 percent in 1983—the first such drop since 1946. A recovery in machinery sales—several forecasters indicated a 10- to 15-percent gain in unit sales—will cause depreciation in 1984 to resume its upward course. The projected increase in machinery sales assumes favorable commodity prices, a return of more normal weather, moderating interest rates, and a substantial rebound in planted acres.

Interest expense was also a moderating force on 1983 production expenses that is likely to resume an upward trend in 1984. Nonreal estate interest expenses are expected to have declined about 5 to 7 percent in 1983 from the $11.3 billion in 1982, due to a decline in the average interest rate on such debt. Interest on real estate debt grew moderately during 1983, with little change in the average interest rate on such debt and a somewhat higher level of outstandings during the year. The improved income situation going into 1984 and the need to finance larger crop acreages are expected to cause increases in the average outstandings during 1984 compared with 1983, and this will result in higher interest expenses.

Income by Farm Sales Classes

Our report of last year explored a number of distributional aspects gleaned from the 1979 Farm Finance Survey, published in July 1982 as part of the 1978 Census of Agriculture. No new primary data of that nature are available for this year's

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Table 5
Summary of Farm Sector's Financial Status by Value of Sales Class, Distributions and Averages per Farm, Balance Sheet Items January 1, 1983 and Income 1982.

Item	Farm Sales Class ($1,000)					
	= or >500	200 to <500	100 to <200	40 to <100	<40	All Farms
Distribution of:						
Assets	10.1%	14.8%	19.5%	24.1%	31.4%	$1,048.8 bill.
Debt	18.3	18.6	20.4	22.5	20.1	216.3 bill.
Equity	8.0	13.9	19.3	24.6	34.3	832.5 bill.
Cash receipts	30.1	19.0	19.3	19.2	12.4	150.1 bill.
Net farm income	62.3	19.6	15.1	8.3	-5.2	22.1 bill.
Off-farm income	1.7	3.0	5.2	10.6	79.5	39.4 bill.
Number of farms	1.0	3.6	7.8	16.4	71.2	2.4 million
Averages Per Farm						
Assets	$4,235,000	$1,783,700	$1,103,500	$645,150	$192,480	$437,000
Debt	1,584,000	461,300	238,000	123,900	25,500	90,100
Equity	2,651,000	1,322,400	865,500	521,250	166,980	346,900
Equity change in 1982	-229,360	-88,540	-50,060	-28,740	-7,160	-19,280
Net farm income	548,197	49,401	17,875	4,656	-668	9,187
Off-farm income	26,831	13,720	11,074	10,615	18,337	16,428
Debt-to-asset ratio	37.4	25.9	21.5	19.2	13.2	20.6

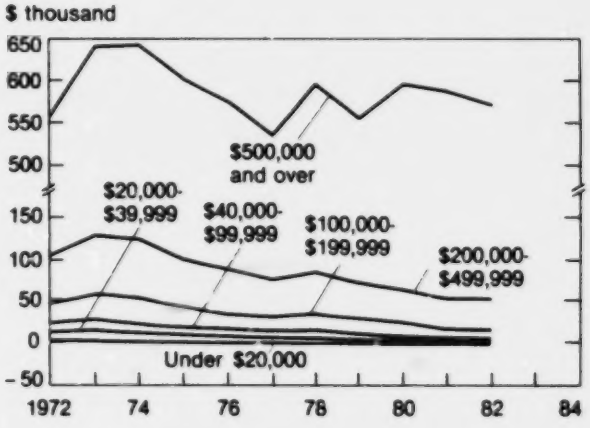
Source: "Economic Indicators of the Farm Sector: Income and Balance Sheet Statistics", 1982, USDA, ECIFS 2-2, October 1983, derived from pages 88 and 136.

report. However, table 5 presents selected income and balance sheet items for 1982 taken from a recent USDA publication, which, among other things, incorporated the 1979 survey findings into the Department's income and balance sheet accounts. The percentage distribution patterns shown for 1982 closely parallel the corresponding ones reported last year from the 1979 census survey. One item that differs significantly is net farm income. This series is more heavily skewed toward the upper sales classes than was the net cash farm income reported last year—that series closely paralled the distribution shown for cash receipts. But because these are quite different concepts, one should not be surprised by the departure in patterns. Net farm income includes certain nonmoney imputations in both income and expenses that alter the pattern of net cash income.

Farms in the highest sales category ($500,000 or more in annual sales) accounted for about 30 percent of total cash receipts, 22 percent of farm-production expenses, and over 60 percent of net farm income in 1982. These 25,000 farms represented about 1 percent of the nation's farms, controlled about 10 percent of all farm assets, and held nearly 20 percent of all farm debt. At the opposite extreme, the 1.7 million farms having sales of under $40,000, representing some 70 percent of all farms, had 12 percent of cash receipts, 20 percent of production expenses, and a negative net farm income. These farms also held about 20 percent of the farm debt, but controlled over 30 percent of the assets. Allowing these units to exist was an average of over $18,000 in off-farm income, which accounted for nearly 80 percent of the farm sector's off-farm income.

In our study of the survey data last year, we separated the assets and debts between landlords and operators and found that operators have significantly higher debt-to-asset ratios than those shown by USDA for whole farm units. When just indebted operators are considered, ratios are still

Average Net Farm Income by Sales Class



Net income before adjustment for inventory change. Beginning in 1975, farm income data reflect a change in the farm definition from a place of 10 or more acres with $50 in agricultural product sales and under 10 acres with $250 in sales, to place with $1,000 in sales.

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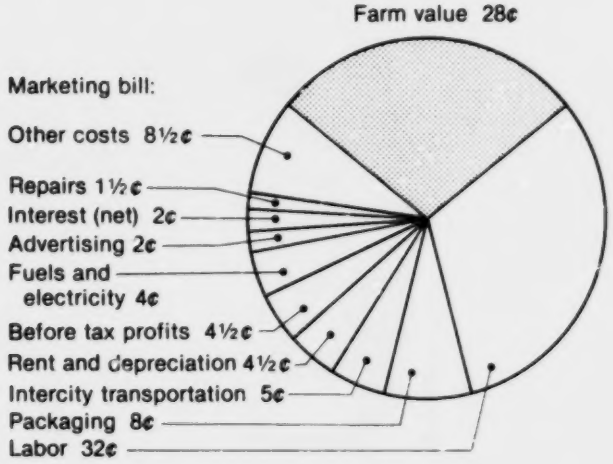
higher. Where USDA's whole farm debt-to-asset ratios range from 13.2 to 37.4 with a 20.6 average, for indebted operators, the average is closer to 36, with a range of 27 to about 50. These ratios are slightly larger for the upper sales classes and smaller for the lower ones, compared with our findings last year. This shift resulted from a slight realignment of debt from lower to upper sales classes in USDA's series after incorporating the 1979 survey findings.

Food Prices

Retail food prices in 1983 averaged slightly over 2 percent higher than in 1982, the smallest annual gain in 16 years. The increase that occurred was greatly moderated by lower farm prices, held down by a combination of large meat supplies and relatively weak demand, and by a reduction in the overall rate of inflation that eased pressure on the farm-to-retail price spread. In a reversal of the recent trend, food prices are expected to come under upward pressure during 1984, particularly during the second half, when reduced meat supplies clash with a growing demand. The causes behind the projected rise can be seen by examining trends underlying the two components of food prices—the farm value and the farm-to-retail price spread. The farm value constitutes about one-third of the food dollar spent for at-home consumption (grocery store purchases) and about one-sixth of the dollar spent for away-from-home consumption (restaurants, etc.).

What a Dollar Spent on Food Paid for in 1982



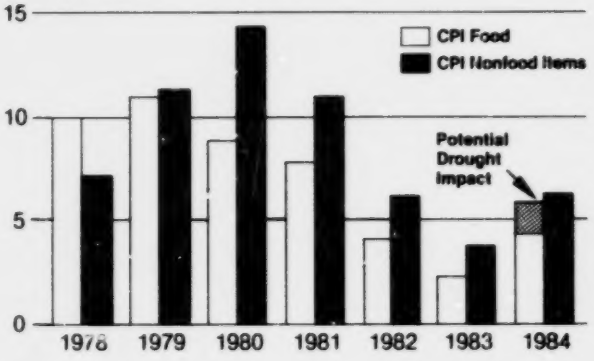
1982 preliminary. Other costs include property taxes and insurance, accounting and professional services, promotion, bad debts, and miscellaneous items.

The farm value of food has risen at a decreasing rate since 1979 as a result of large crop and livestock supplies, coupled with weak domestic and foreign demand. Increases in the farm-to-retail price spread have also slowed in recent years; the price spread was expected to rise about 4 percent in 1983. With the decrease in the general inflation rate and the recession, increases in labor costs (which account for about half of marketing costs) have been moderate.

In 1984, food marketing costs are expected to rise 4 to 5 percent, slightly above this year's rate. Labor costs are expected to remain moderate, with no change in the minimum wage, and a small increase in social security costs. The continuing economic expansion will put upward pressure on other marketing costs. The 1983 drought and acreage-reduction programs have cut feed supplies and raised the price of all feedstuffs, prompting livestock producers to reduce animal inventories. Initially, meat animal prices will be lower, but as supplies dwindle, prices will begin to rise, increasing the farm value.

The outlook for 1984 food prices is for an increase of around 5 percent in the CPI for food over the 1983 average. The outlook for moderate increases in marketing costs and for strong economic conditions underlies most of the increase. The price pressure from the drought and the planting reduction is expected to be more important in shaping the yearly pattern of food prices than in forming the annual average. Mixed effects have appeared already, with lower meat prices offsetting rises in the prices of fat and oil products that are responding to lower soybean, cottonseed, peanut, and sunflower seed supplies.

Increases in Consumer Price Indexes
Food vs. Nonfood Items
Year-over-year Percent Change



Source: Consumer Price Index: Bureau of Labor Statistics

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Table 6
Food Price Indicators and Market Basket Statistics, 1979 and 1981-84
Percent Changes from Previous Year.

Item	1979	1981	1982	1983[1]	1984[1]
All food — CPI	**10.9**	**7.9**	**4.0**	**2.2**	**4 to 7**
Food away from home	12	9.0	5.3	4.4	4 to 7
Food at home	10.8	7.3	3.4	1.1	3 to 6
Market basket of food-Retail	11.7	7.7	3.8	1.1	3 to 6
Farm value of retail cost	10.7	2.8	1.0	-4.5	4 to 7
Farm-to-retail price spread	12.3	10.5	5.1	4.0	3 to 5

[1] — USDA forecast

Therefore, most of the increase in food prices will come in the summer and fall. Food prices will rise at a slow rate early in the year, but will go up sharply from July to September when beef and pork supplies are lowest. Thus, the price increase during the year is likely to be around 8 to 10 percent, which gives rise to an overall 4- to 7-percent range for the year-over-year average increase in retail food prices.

Agricultural Exports

Since 1980 and 1981, when U.S. agricultural exports peaked in volume and value, respectively, export market performance has declined steadily. World trade in agricultural commodities has generally shrunk over the period, but the U.S. share of world exports has diminished as well. A declining share of a declining market has shaken the ardor that American agriculture has had for foreign markets. American farmers probably find it ironic that increased competition has resulted in a general shift towards protectionism in world markets.

In addition to several factors discussed in the foreign trade section of the previous chapter—namely, the strength of the U.S. dollar, foreign debt burdens of developing countries, and worldwide recession—the level of our agricultural exports has been affected by changes in production outside the United States. Thus, not only have economic woes dampened the demand for agricultural products in importing countries, their generally favorable weather in recent years has cut their need to import on a large scale. But not all the global production growth has been weather related; a significant part has been due to economic incentives, including some that were policy induced.

While the United States was the only country able to respond quickly to the tremendous increase in world agricultural demand during the 1970s (bringing into production previously idled land), many other countries adopted policies leading to expansion of their own agricultural production and export potential. Beyond following their own policy signals, producers in competing countries observed those being given to American producers. During the past several years, our program loan rates, the reserve mechanism, and the strong dollar have combined to provide reasonably effective and attractive price floors for them. More recently, supply-control measures unilaterally implemented by the United States, as represented by the payment-in-kind program, have told them that there would be a falling tide of American export supplies, and they have again responded by increasing acreages.

Table 7
U.S. Agricultural Exports: Value and Volume by Commodity, Fiscal Years 1982-1984

Commodity	1982	1983	1984[1]
Value: $ Billion			
Grain and feed	17.6	15.2	17.7
Oilseeds and products	9.7	8.9	10.0
Livestock and products	3.2	3.0	3.2
Poultry and products	0.6	0.5	0.5
Dairy products	0.4	0.4	0.5
Horticultural Products	2.8	2.7	2.8
Tobacco	1.5	1.5	1.4
Cotton and linters	2.2	1.7	1.8
Seeds	0.3	0.3	0.3
Sugar and tropical products	0.8	0.7	0.8
Total[1]	**39.1**	**34.8**	**39.0**
Volume: Million Metric Tons[2]			
Wheat	44.6	36.7	37.5
Wheat flour	0.7	1.6	1.1
Feed grains	58.2	53.8	55.6
Feeds and fodders	6.1	7.0	6.7
Rice	2.9	2.3	2.2
Soybeans	25.5	24.5	19.6
Soybean cake and meal	6.3	6.4	5.2
Other oilseed products	2.9	2.8	2.1
Beef, pork and variety meats	0.4	0.4	0.4
Poultry meat	0.3	0.3	0.3
Animal fats	1.5	1.4	1.4
Tobacco	0.3	0.2	0.2
Cotton and linters	1.6	1.2	1.2
Horticultural products	3.1	3.0	3.1
Other	3.7	3.2	3.4
Total[1]	**157.9**	**144.8**	**140.0**

[1] Totals may not sum due to rounding.
[2] Shown in actual export tonnages, converted to product equivalents. Excludes some items not easily convertible.
[3] — USDA forecasts

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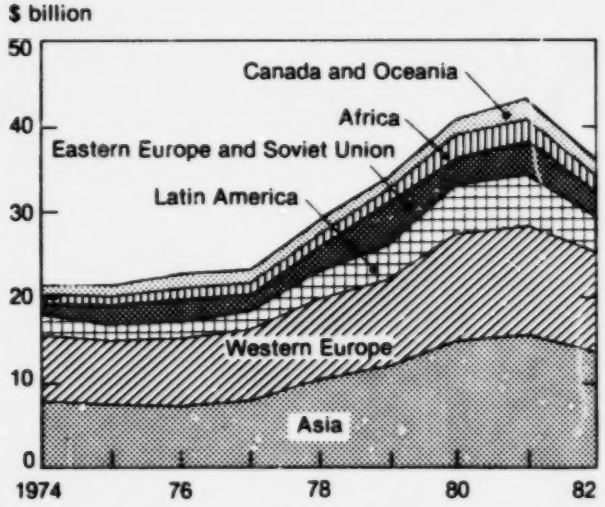
Commodity Supplies

U.S. wheat production in 1983 was 14 percent below the record output of 1982. Production of wheat outside the United States is expected to increase about 3 percent during the 1983/84 period, offsetting our drop and establishing yet another record world crop. The increased production by competing exporters will likely cause U.S. exports of wheat to decline in 1983/84, while their own will increase, and global trade is anticipated to remain near the 1982/83 level.

Domestic rice production declined 30 percent in 1983. In contrast, foreign rice production may increase marginally, about 2 percent greater than the output level of 1982/83. However, drawdowns of stocks are likely to permit both the United States and its major competitors to maintain the same export levels in 1983/84 as were recorded for the previous year.

Cotton production in the United States declined even more percipitously in 1983 (38 percent) than it did in 1982 (23 percent). In contrast, production of cotton outside the U.S. could increase as much as 4 percent after edging slightly higher in 1982/83. With considerable optimism for consumption to exceed production, world and especially domestic stocks should decline. American exports in 1983/84 are expected to edge above the reduced level achieved in the previous year. The market share of other exporters most likely will decrease slightly.

U.S. Agricultural Exports by Destination



Adjusted for transshipments through Canada.

Reflecting drought-diminished yields and less acreage, American soybean production declined about one-third from 1982 and one-fourth from 1981. Meanwhile, soybean production in other countries is expected to increase about 7 percent over 1982/83, which is 12 percent above the level for 1981/82. U.S. exports of raw soybeans are expected to decline slightly (−2 percent), reflecting in large part the increased production of vegetable oils in India.

Domestic production of feed grains, reflecting reduced plantings due to the PIK program and lower yields due to drought, declined by 45 percent in 1983. Somewhat surprisingly, U.S. exports may increase slightly because of our record carryover stocks from 1982/83, while competitor supplies will be tight until Southern Hemisphere harvests this spring. Drawdowns of U.S. stocks will be dramatic, declining over two-thirds from the record large 1982/83 levels. Stocks in the rest of the world will drop much more modestly, perhaps 17 percent.

Importer Demand

The developed countries of Western Europe, together with Canada and Japan, have traditionally been our most important customers for agricultural products. That importance will continue for the foreseeable future. Recovery in the economies of these countries, a recovery that has lagged that of the United States, is a major reason for the anticipated strength of trade with other OECD nations. Growth of export trade with this group of countries has its limitations, however. Among the most important of these limitations is the rapidly increasing production within the European community.

Responding to price and capital expansion incentives embodied in the community's Common Agricultural Policy, the EC has recently emerged as an important exporter of livestock and poultry products, sugar, and wheat. Export capacity has been built on what amounts to a long-term structural adjustment of the EC's agricultural sector. As a consequence, the presence of the EC in world markets must be taken as a fact of life. However, their impressive increase in agricultural production has been achieved at substantial cost, a cost that has become increasingly burdensome for the economies of member nations. Recent proposals for the reform of the CAP would have the effect of restricting import volumes of several categories of agricultural products important to the United States. Should these proposals be adopted, exports to the EC would be adversely affected, not only in 1984, but in subsequent years as well.

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Developing countries represent even bleaker prospects for U.S. agricultural exports in the near term. Over the past decade, these countries have borrowed heavily from commercial banks in developed countries. In retrospect, the level of lending done by banks neither served the best interests of developing countries nor represented prudent credit practices. It resulted in massive debt assumed by countries whose only hope for meeting debt service obligations lay in constantly increasing earnings from the export of basic commodities. This topic is treated in greater detail in the preceding chapter under Foreign Trade.

The road to recovery for many developing countries will not be an easy one. Whether they require further rescheduling of the debt with commercial banks and/or IMF assistance, conditions placed upon further extensions of credit often require debtor nations to adopt stringent fiscal measures. Because of the widespread use of food subsidies in developing countries, reduction or elimination of these subsidies is often one of the first actions taken to impose fiscal discipline. The intended effect is to reduce the reliance upon food imports, thereby conserving scarce foreign exchange and improving the current account balance.

The economies of centrally planned countries (CPCs) are no more insulated from the effects of global recession than are those that profess to be "market oriented." Much of the export trade to eastern European countries over the past decade was fueled by easily available credit. Much of that credit was not and will not be repaid as scheduled. The dilemma for many Eastern Bloc countries is not unlike that of the developing countries. They will be forced to impose the discipline of lessened reliance on imported food to increase living standards. The Soviet Union, like many raw material-exporting countries, relies on petroleum exports to earn foreign exchange. Its balance of payments has suffered as much as those of other petroleum-exporting countries. The capacity of CPCs to import food, and thereby improve living standards, has seriously eroded. While a certain level of imports will be required, the growth in imports so much in evidence since 1972/73 will not be reestablished for several years.

Policy Issues

Events since the 1981 farm legislation, which have culminated in huge budget outlays, dictate that significant changes are needed in nearly all our farm commodity programs. The USDA argues that, while many variations may be proposed, the eventual policy outcome will either represent a move toward greater market orientation with price variability or a shift to greater supply control to achieve price stability at or near some desired level. Polarization at the extremes appears to be unusually strong. Proponents of both extremes seem to recognize that the level of U.S. agriculture is a function of the world marketplace and that the normal state of world agriculture is one of imbalance. Not so clearly seen is how our domestic policy shapes our role in various foreign markets, and, in turn, how the nature of those markets should help shape our policy.

While many issues are involved in determining domestic farm programs, how the United States approaches world markets probably has the greatest significance to the future scope of U.S. agricultural output. The dominant role played by the United States in bulk agricultural commodity trade suggests to some that we are in a position to set whatever price we desire. To others, it suggests the need to willingly accept relatively low prices in order to avoid giving other nations a signal to expand their output.

U.S. dominance in world markets increased considerably during the 1970s, as our producers supplied the lion's share of the world's growing food needs. A combination of events led to our soaring exports: crop failures abroad, general economic prosperity, rapid expansion of credit to developing countries, a relatively weak U.S. dollar, and a willingness of our crop producers to bring increased acreage into production—much of it from areas that had been idled during the 1950s and 1960s. Other countries were not in a position to bring additional acres into production quickly, but with adequate incentives, they have demonstrated a substantial capacity to increase their agricultural output.

Thus, our export growth was achieved because we were able to fill a growing demand quickly. It was not because we were competitively taking away the market from others in an open world trading system. For most of our major agricultural crops, the United States is the dominant exporter and a residual supplier. Importing countries fill their needs first from domestic production, and other exporters with much smaller supplies can often undercut our price. Our competitors typically move their exportable supplies quickly after harvest by taking a price that will move what is available. The United States has been left bearing the brunt of world stock adjustments.

Whereas the long-term trend in U.S. farm policy has been toward making our programs more market oriented, many foreign countries have been moving in an opposite direction with export sub-

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sidies and trade restrictions. Our policies presumed a growing world demand to be filled on a competitive basis. A problem now evident with the 1981 farm legislation is that it gave our producers the signal to grow and market their grain through the farmer-owned reserve, while, at the same time, it signaled to competing nations price levels below which the United States would effectively be out of the market.

Beyond the budget exposure entailed in a grain-reserve program, the major question that our recent experience raises is whether we can devise a pricing scheme for such a reserve that does not undermine our position in world markets. The fear of those espousing a market-oriented approach is that price-support floors and/or production controls will lead to a continuous erosion in our export market position and will, eventually, leave us producing for a domestic market only.

A generally market-oriented U.S. agriculture has, over the years, given domestic consumers abundant food supplies at relatively low prices—something they have taken for granted and have come to expect. While restrictive market orders and quota systems have come under fire, consumer advocates recognize the need for adequate returns to producers to ensure steady supplies. What type of price structure or supply management this should entail, just how many producers could survive it, and what role it leaves the U.S. in world markets are major unknowns.

Research conducted at Oklahoma State University shows that the price requirements for different-sized farming operations vary tremendously. Using 1981 data, the smallest farms (sales under $5,000) required 281 percent of parity, whereas farms having $40,000 to $200,000 in sales needed 80 percent, and the largest farms required only 54 percent of parity to cover all costs. One conclusion was that domestic farm prices, which were at about 61 percent of parity in 1981, may not be abnormal in that such a level may be adequate to induce output in line with demand, while providing returns that cover all costs on well-managed farms of sufficient size.

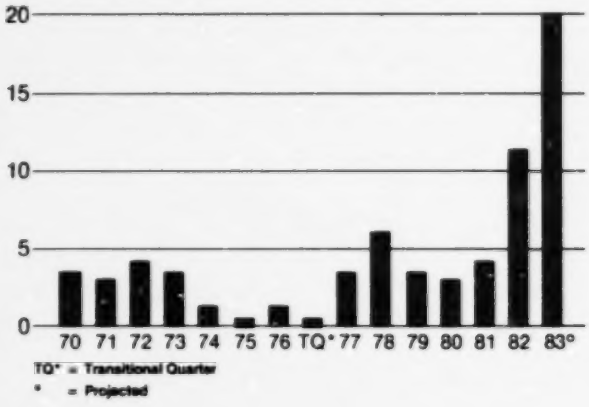
The competitive advantage that U.S. producers sense they hold is based on a long-run perspective of being able to underbid producers in other countries. If, indeed, this is the case and other producers were not subsidized, the United States could expect a growing share of the world market, although the price level would not necessarily be satisfactory for a large number of our producers. Midsize, full-time farmers could continue to face difficult times.

Huge budget outlays and the distribution of program benefits to a relatively small group of large producers are likely to receive considerable public attention during deliberations leading to 1985 farm legislation. A record $21 billion in fiscal 1983 outlays included about $5 billion in direct payments (deficiency, diversion, storage, and disaster), nearly $9 billion in net CCC lending for commodity loans, $2 billion in net dairy product purchases, and $5 billion in all other CCC operating outlays. Whereas the focus may be on the distribution of PIK benefits, the 1983 outlays were only marginally related to the 1983 farm programs. A point to keep in mind is that prior legislation, rather than PIK, was what culminated in the huge outlays.

There is little question that PIK accomplished much of what the Administration hoped to achieve, but the price was somewhat higher than anticipated. The exceptionally good weather for winter wheat and extremely unfavorable conditions for most summer crops blurs any precise assessment of the program's benefits and costs. The past 2 years have taught us that farm programs can get out of hand quickly, and at the same time reminded us of nature's powerful and totally unpredictable adjustment mechanism. There are lessons here for those wishing to fine-tune a supply-control program to achieve price stability at some desired level within the bounds of acceptable public cost.

In attempting to deal with these various issues, producers and their organizations will find they must contend with a growing number of national concerns that go beyond traditional farm policy issues. A broader range of participants will give greater emphasis to national security and economic development, resource conservation and environmental issues, monetary and fiscal responsibilities, as well as the quality and adequacy of food supplies at reasonably stable retail prices.

Net Outlays for Farm Price Support Programs
$ Billion



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III. AGRICULTURAL FINANCE OUTLOOK

Introduction

Stronger farm prices and rising income have injected a note of optimism into the agricultural finance outlook for 1984. After 3½ years of accumulated stress, news about a possible turnaround in the farm sector is certainly welcome. There is a possibility, however, that this prognosis for financial improvement may be very premature. The tremendous diversity that exists in individual financial situations will pose major challenges to lenders in the year ahead. Indeed, in terms of loan servicing requirements, 1984 could prove to be a more difficult year than the one just ended.

The apparent inconsistency between rising net farm income and deteriorating credit quality is easily reconciled by examining individual income and credit situations. While it is true that total net farm income is improving, many individual farmers are facing severe financial distress because of low commodity prices, the 1983 drought, declines in asset values, and unexpectedly high interest rates. For those who have experienced 3 consecutive years of hardship, one good income year will not totally solve the problem. It may take several successive years of strong earnings for many farmers to reestablish their financial footing.

Seldom has the farm income situation been characterized by so much diversity. The past year has been one in which some farmers have enjoyed record incomes, while others—perhaps neighbors just a few miles away—have experienced near total disaster. The particular outcome mostly depended on whether the producer participated in the PIK program, whether the farm was hard-hit by drought, or whether the operation was primarily involved in livestock production. Generally, PIK participants and those who escaped the drought fared very well in 1983; those who elected to bypass PIK and were greeted by hot, dry weather during the summer suffered a disaster; and those who were engaged predominantly in livestock production did poorly regardless of the circumstances.

Not all farmers have benefitted from the surge in commodity prices that occurred during the second half of 1983. Some of those receiving PIK distributions forward-contracted at least a portion of their grain at prices well below current levels. Other farmers produced very little output because of the drought, and for them, prices are almost immaterial. Still others, though, were in areas little affected by the drought, and they have profited substantially from the higher prices.

Depressed farm incomes have been blamed for most of the deterioration in credit quality since 1980. Last summer, however, USDA significantly revised the farm income figures for 1980–82, increasing them above those reported earlier. A troublesome question that clouds the picture for 1984 relates to the true gravity of the credit situation. How bad would the credit picture be today if net farm income had really been as low as first reported? Chances are that foreclosures and bankruptcies would be running rampant, and that the farm financial situation would be even more of a political issue than it is already.

Because of concerns over the farm credit situation, lenders will continue to exercise caution in their lending practices for 1984. Plenty of funds will be available again for creditworthy borrowers, but lenders will be tightfisted about lending money to borrowers with marginal repayment capacity, even if there is adequate collateral. These credit-rationing procedures by commercial lenders will likely create greater demands on Farmers Home Administration programs. Although there is budget pressure to continue scaling back these programs, the credit needs of agriculture are such that some expansion in funding is likely.

There are other precautions that commercial lenders will employ in 1984. The slowdown in the farm real estate market since 1981 has removed a major safety valve in agricultural lending practices. In the 1970s, when land values were soaring, lenders were able to lend money to farmers with weak repayment capacity because the land represented excellent collateral and could be used for refinancings and reamortizations. However, now that those halcyon days are but a memory, the ability to repay loans will be weighed very carefully before credit is extended in 1984.

In addition, lenders can be expected to encourage farm borrowers to minimize their risk exposure as much as possible by buying crop insurance, if available, by forward-contracting some of their products, or by participating in the 1984 farm commodity programs. Although the program features have been announced, the extent to which farmers choose to participate in the new programs is still a major unknown. Because benefits have been reduced for the coming year, participation rates are expected to drop from 1983's unusually high levels. A sharp drop could easily lead to record-high acreages of feed grains and soybeans, setting the stage for a return to bumper crops and low prices if 1984 growing conditions are favorable.

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Nonparticipants in the programs, of course, will not be eligible for the price protection of CCC loan rates. Thus, a key decision for many farmers in 1984 will be based on their ability to withstand price risks. The role that lenders play in helping customers make this decision could produce higher-than-expected participation rates in the commodity programs for 1984.

Livestock producers also will have some difficult decisions to make in 1984. Current economic conditions call for adjustments in output so that profits can be restored. Some producers, however, anticipating that feed costs may drop sharply during the second half of the year with animal prices rising, may decide to gamble on maintaining herd sizes and breeding programs to take advantage of this situation. Once again, lenders may try to influence the decisions of livestock borrowers who are not in a good position to gamble.

The events of the last few years have produced significant changes in the market shares of farm debt held by various lenders. Government lending programs have expanded sharply, led by Commodity Credit Corporation price-support loan activity. As of July 1, 1983, CCC loans outstanding were about 60 percent above the year-earlier level. Commercial banks have also increased their market share in the past year, as outstandings are up about 7 percent. With deregulation and the introduction of money market deposit accounts, the liquidity of commercial banks is the highest it has been in 7 years. Consequently, many banks are aggressively seeking good quality farm loans. In the past year, they have successfully attracted these credits, even when charging interest rates above those of their major competitor—the production credit associations. Although the PCAs were offering attractively priced credit to their borrowers, their market share of nonreal estate loans declined in 1983 as loans outstanding dipped about 8 percent.

The year ahead will be a challenging one for all entities in the Farm Credit System. Uncertainty about prices and individual income situations, as well as concerns about maintaining System earnings as loan losses mount, will encourage conservative loan decisions in 1984. Fortunately, the structure of the System's bond portfolio should permit PCAs, FLBAs, and the BCs to offer competitively priced loans to their customers, given that the cost of replacing maturing obligations should not change appreciably in the year ahead. In the sections that follow, we look at the financial condition of agriculture and make judgments about the roles that individual lenders will play in 1984.

Financial Status of Borrowers

Variations in Farm Income

While total net farm income is clearly on the rise, this trend masks the financial hardships that many farm operators are experiencing because of several economic developments that have occurred over the last 3 or 4 years. Within the past year, the combination of drought and acreage-reduction programs, particularly PIK, has fostered more variation in individual income situations than ever before. Consequently, it is impossible to make general statements about the farm income picture without acknowledging that wide variations exist both within and among enterprise groups and geographic areas.

One of the ironies of the current farm income situation is the way in which fate has treated individual farmers so capriciously. For example, there are some farmers who entered 1983 in good financial condition, but are now facing severe stress because they chose not to participate in PIK and were hit by the drought. Although their business decisions may have been sound, their luck was bad. And then there are those farmers who entered the year in dire straits because of poor management practices, bad luck, or various other factors. Some of these farmers have significantly improved their situation, not necessarily because they made astute decisions, but because they received the windfall benefits of good weather and strong prices. The ultimate irony is that many of these same farmers were strongly encouraged by their lenders to participate in PIK—in some cases as a condition for refinancing their debts. The results of this action turned out to be extremely beneficial to most PIK participants, no matter how willing or unwilling they may have been. As a group, winter wheat producers were an exception; record yields and little price improvement meant little variation in their incomes as a result of being in or out of the program.

Although subject to variation, financial conditions in the livestock industry are uniformly depressed. Very few livestock operators can reflect back on 1983 with any enthusiasm, given the significant losses in liquidity and the rapid deterioration in balance sheets. The safety nets embodied in farm programs provide few direct benefits to the livestock sector, although there are some indirect benefits. In 1983, however, the programs that were so helpful to the crop producer proved to be quite harmful to the livestock operator. Again, it is probably fair to say that much of the livestock industry was victimized by fate in 1983.

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Illustration of Income Extremes—The following example illustrates the types of income extremes and ranges in loan-repayment ability that occurred last year, depending on decisions about participating in the corn PIK program and the effects of the drought. A typical Corn Belt cash grain farm is used; it has 600 acres producing corn and/or soybeans with normal yields of 115 and 35 bushels, respectively. For this purpose, the established corn base is taken to be either 300 or 600 acres, and the results of three basic production choices are examined in concert with three weather conditions, which impacted yield levels.

For each combination of production decisions and weather conditions, the producer's net agricultural income available to service debt, to provide a return on family resources, and to replace equipment was computed. The variable cost estimates exclude any debt service and machinery replacement cost. If the producer normally arranges for an operating loan to cover anticipated operating expenses, the amount borrowed in the spring could have ranged from about $100,000 for 600 acres of corn to under $10,000 for a 600-acre whole-base bid. Other than for the extreme crop loss combined with a full decision production, the producer would have had adequate earnings to service the interest on such operating loans. Servicing a sizable mortgage debt is another matter. If yields were cut by as much as 40 percent and the producer was not in the whole-base bid, net income may not have been adequate to service the mortgage debt.

Table 8
Net Income Possibilities for a Typical 600-acre Corn/Soybean Farm, 1983*

Production decision	Normal crop yields	40% crop loss	80% crop loss
300 acres corn & soybeans			
Full production	$140,250	$ 60,150	$-19,950
PIK at 30%	136,380	78,480	20,580
PIK, whole base	156,315	120,615	84,915
600 acres corn			
Full production	139,500	51,900	-35,700
PIK at 30%	131,760	88,560	45,360
PIK, whole base	171,630	172,830	174,030

*Net income available for debt service and as a return on family resources.

The production decisions include: (1) full production, (2) participation in the corn PIK program at the 30-percent level, and (3) whole-base PIK bid at the maximum. With both PIK options, there was a 10-percent paid diversion that yielded $172.50 per acre, and for the 30 percent PIK, a 10-percent set aside of the corn base was also required. The 30 percent PIK meant only one-half the corn base acreage was planted to corn, the other half being devoted to conservation use. For the 300-acre corn base situation, 300 acres of soybeans were produced under each of the three production decisions. The assumed weather conditions are: 1) no loss from normal production, 2) 40-percent loss of normal yields, and 3) 80-percent loss of normal yield due to extreme drought.

The tabulated results are based on the following assumptions concerning prices and production costs. The producer managed to receive $3.50 for corn, whether new crop or PIK, and there was no deficiency payment from participation. Soybeans brought $9 per bushel. Variable costs for producing a normal corn crop are estimated at $170 per acre and are lowered $15 for each 40-percent loss in yields. The similar figures for soybeans are $80 per acre lowered by $5, and for conservation use acres, $21 lowered by $2, the latter reflecting less need for mowing.

Assuming the 600 acres is bare land with no improvements in the form of buildings, the value per acre could reasonably be $2,000 for a total investment of $1.2 million. Mortgage debt of 40 percent or $480,000 at 12 percent for 30 years requires nearly $60,000 annually to service the debt. With 50 percent equity or $600,000 in mortgage debt on the same terms, the debt service requirement is $74,000 a year. Such debt service requirements applied against the various income situations indicate the impact of leverage, the production decision and weather upon the producer's subsequent debt level, and net worth position.

Thus, the income extremes shown in the table could be widened considerably more after taking into account debt servicing requirements. A majority of producers having an established corn base did participate in the 1983 corn program, but the degree of participation varied greatly; a relatively small number were in with a whole-base bid, and few of these probably had their corn base matching their entire cropland acres. Some corn producers actually fell into each type of income cell illustrated in this example, and in each case their debt service requirements could have ranged from none to in excess of the levels cited above. One should also recognize that 1983 was a year in which crop insurance could have paid handsome returns. While use of such insurance was down, it was yet another factor helping to both moderate and amplify income extremes among neighboring farmers.

Balance Sheet of the Farming Sector

Eroding asset values and rising debt is the damaging trend observable when comparing the January 1, 1983, farm sector balance sheet to the January 1, 1982, financial statement. Specifically, total farm assets declined 3 percent from 1982 levels, and total debt increased 7 percent, resulting in farm sector equity declining by 5.5 percent. Financial gloom was not to prevail in 1983, however, as major economic forces including the 1983 Government programs and the Federal Reserve combined with nature to provide a favorable trend reversal. As 1983 was drawing to a close, the outlook for the January 1, 1984, statement was for total assets to rise 1 to 5 percent and for total debt to rise or decline as much as 2 percent; thus, equity was expected to rise 1 to 7 percent.

1983 Financial Condition Changes—A closer look at the January 1, 1984 estimates for agricultural assets shows that real estate, accounting for 75 percent of all assets, is expected to have risen 2 to 4 percent. The 1983 increase would recoup some but not all of the loss experienced over the last 2 years. Factors contributing to the anticipated rise

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include improved farm earnings and interest rates lower than the year before.

The recent retreats in farm asset values were almost wholly due to changes in farmland values. The declines that were experienced during the past 2 years were not homogeneous in the contiguous 48 states. The Corn Belt region bore the brunt of the declines, falling a total of 21 percent from 1981 to 1983. Not since 1931-1932 had land values fallen 2 years in a row. Since 1932, downturns in farmland values have occurred in 1938 and 1953. Just as the decline in the farmland market did not occur in a homogeneous fashion, neither will the prospective upturn. Generally, those areas most affected by the recent declines are expected to show the most rapid gain. An exception even to this trend will be those areas hardest hit by drought, which probably did not share proportionately in any of 1983's second-half gains.

The nonreal estate asset accounts (livestock and poultry, machinery, crops, household equipment, and financial assets) are expected to have changed by between a 2-percent decline and a 7-percent increase during 1983. The outcome will depend to a high degree on the marketing of the PIK entitlements. Such marketing can be delayed for up to 5 months due to the 5-month paid storage provision of PIK, which will affect how much of the change actually occurred in 1983.

Farm sector liabilities grew at double-digit compound rates during the latter half of the 1970s. There is the prospect, however, that outstanding farm debt may have declined for the first time since 1945, mostly because of a major reduction in CCC debt outstanding. The 1983 PIK program and drought substantially reduced the massive amount of grain under loan to the CCC. Also, the high commodity prices in the last half of 1983 triggered the release of uncommitted feed grains from the farmer-held reserve programs and made the placement of new crops under CCC loan relatively unattractive. Less dramatically, farm real estate debt is forecast to increase 2 to 4 percent. This is about equal with last year's change, but well below the 10-to 13-percent increase observed in 1980 and 1981.

While the estimates for the January 1, 1984 farm sector balance sheet show favorable changes in many of the accounts in nominal terms, the story in real terms is less optimistic. The forecast for real (1972 $) proprietors' equity shows that inflation-adjusted farm wealth could range from a decline of about 3 percent to a rise as large as 2 percent. Although any of the values in the range would be a marked change from last year's

Table 9
Balance Sheet of the Farm Sector, 1981 to 1984
$ Billion

Item	1981[r]	1982[r]	1983[p]	1984[f]	Changes, 1983 to 84
Assets:					
Real estate	828	819	773	798 ± 7	25 ± 7
Nonreal estate	262	264	276	282 ± 12	6 ± 12
Total	**1090**	**1083**	**1049**	**1080 ± 20**	**31 ± 20**
Liabilities:					
Real estate debt	96	106	110	113 ± 1	3 ± 1
Nonreal estate debt	86	96	106	102 ± 3	−4 ± 3
Total debt	**182**	**202**	**216**	**215 ± 4**	**−1 ± 4**
Equity	**908**	**882**	**833**	**864 ± 24**	**31 ± 24**

[r] = revised, [p] = preliminary, [f] = forecast

10-percent real decline, the inflation-adjusted equity of the farm sector will still be 18 to 22 percent lower than the 1980 peak.

1984 Financial Condition Outlook—The end of 1984 should see the strengthening of most of the favorable trends started in 1983. The value of total assets generally should continue to expand with the value of crops, livestock, and real estate leading the way. Factors that are needed to help sustain the increases include continued expansion of the general economic recovery to include greater demand for farm sector products, as well as a reasonably stable farm income outlook. Short-term debt could increase sharply as crop farmers return most of their 1983 idled land to production again. Real estate debt will be up moderately from 1983 levels, continuing the 2-year trend of moderate real estate debt increases, compared to the double-digit rates of the late 1970s.

The factors influencing farm-sector assets and liabilities will produce the second consecutive year of proprietor-equity increases. This prospective increase should show that farm sector adjustment to a sounder financial base is taking place.

Credit Quality of Lenders

Farm Credit System—The rate of Farm Credit System delinquencies reached a seasonal peak in the first quarter of 1983 before ratcheting downward in the second and third quarters, but the levels remained higher than in the same periods of 1982. On September 30, 1983, 2.75 percent of the 664,676 FLB loans had some amount past due, compared to the fiscal 1983 seasonal high of 4.0 percent on March 31 and 2.31 percent a year earlier. With 9 of 12 districts reporting, the number of PCA delinquencies was 4.2 percent of the

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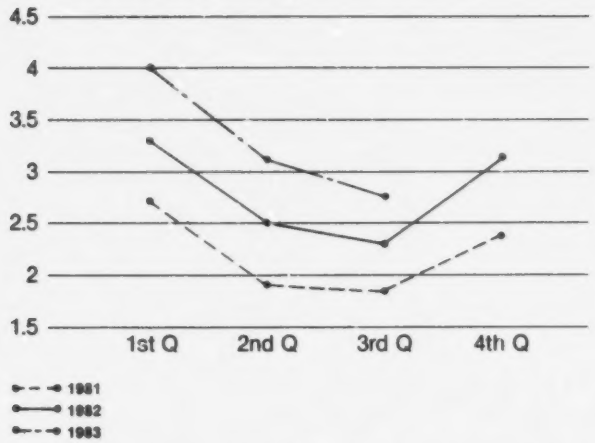
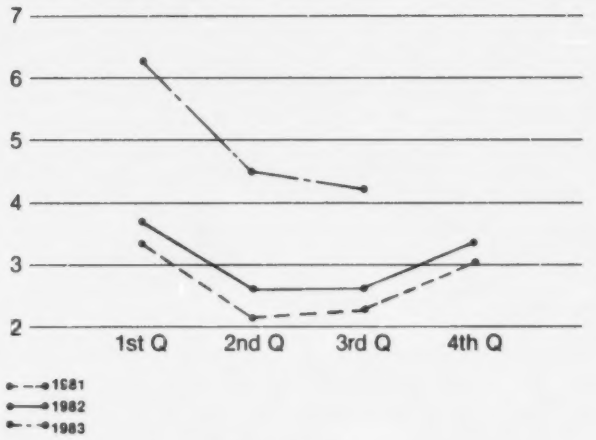
FLB Delinquencies
Percent of Number of Loans



PCA Delinquencies
Percent of Number of Loans



number of loans outstanding, down from 6.3 percent in the first quarter, but higher than the third quarter 1982 rate of 2.7 percent.

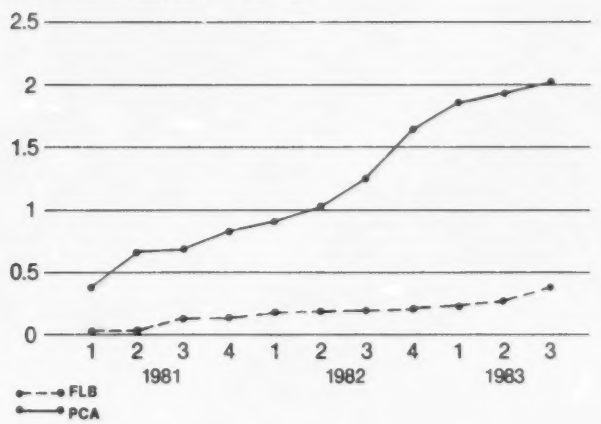
A more telling sign of the severity of financial stress among System borrowers is measured by the amount of loans in the process of liquidation. Although loans in the process of liquidation continued to increase rapidly during the first half of 1983, they still constituted only a small portion of the FLB and PCA loan portfolios. On September 30, 1983, 1.0 percent of the FLB loan amount and 0.4 percent of the number of loans were in liquidation. Comparable figures from a year earlier were 0.54 percent and 0.24 percent, respectively. With 10 of 12 districts reporting, the figures for PCA loans in liquidation were 2.57 percent of volume and 2.10 percent of number of loans outstanding, up from 1.5 and 1.4 percent a year earlier.

While farm financial stress has been widespread and most credit monitoring statistics remain high, most System bankers anticipate an improvement in credit quality in some enterprises in 1984. A little more than one-half of the lenders that cite grain farming as one of the most important enterprises in their districts believe that net farm earnings and the repayment ability of their customers will show signs of improvement in 1984. System lenders serving cow/calf operations anticipate a deterioration of their customers' net worth and repayment potential as higher grain costs and depressed cattle prices were taking a toll.

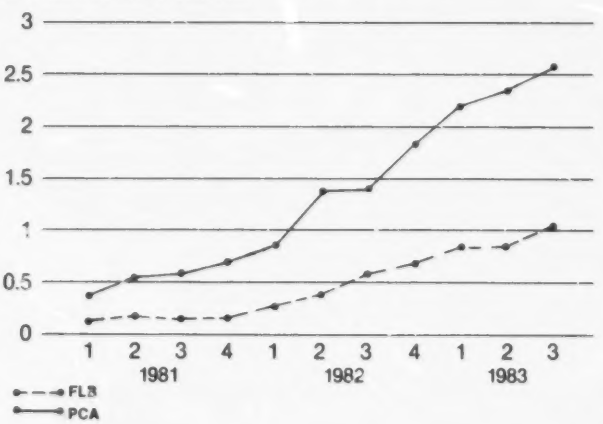
For 1984, System lenders project that on the average about 30 percent of their borrowers are expected to be loaned up to their practical limit and would not qualify for additional loans. The projection is slightly less than what they felt was the 1983 actual level.

Lenders identified several characteristics shared by borrowers who are in the most difficult financial position. Many are highly leveraged, especially

FCS Loans in the Process of Liquidation
Percent of Number of Loans



FCS Loans in the Process of Liquidation
Percent of Loan Volume



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among grain and row crop farmers, and are still attempting to pay down the high levels of debt that were accumulated over the last several years. A number of problem borrowers have a severe weakness in production and financial management skills, and many have a weak equity position that has been eroded by declining land values and high debt levels.

Growing numbers of farmers who are experiencing serious financial difficulties have adopted measures of their own to alleviate their plight. Most notably, farmer borrowers have curtailed capital and production needs, and this contributed to the PCA system's second consecutive year of declining loan volume and outstandings. Although the PIK program was directly responsible for a large portion of declining loan demand in 1983, even in the absence of PIK, many producers have recognized the need to cut back on production credit. Other borrowers in more desperate financial straits have resorted to either restructuring their current expenses or reducing their debt burden by liquidating assets.

Commercial Banks—A mid-1983 American Bankers Association survey of agricultural commercial banks reveals that credit conditions among borrowers showed little or no improvement over the course of the year ending June 30, 1983. On a positive note, the delinquency rate among all agricultural banks declined slightly to 3.7 percent on June 30, 1983, from 3.9 percent a year earlier. During the year, commercial banks discontinued 2.9 percent of their borrowers, compared to 3.3 percent a year earlier.

On the negative side, the percentage of borrowers who went through bankruptcy proceedings increased in 1982-83 from 0.75 percent of all borrowers to 1.07 percent. Although this represents a small percentage of all borrowers, the rate increased significantly in the northeastern and western states, particularly among cow-calf operations.

When asked to comment on the competitiveness of the PCAs serving their market area in 1983, 25 percent of the respondents remarked that the local PCAs were less competitive than in past years. Another 56 percent saw no noticeable change in PCA influence, and the remaining 17 percent viewed the PCAs as having substantially more importance within their region.

For the year ending June 30, 1984, bankers anticipate that roughly the same percentage of borrowers (28.6 percent) will be loaned up to the practical limit, but that a smaller percentage (2.0) will be discontinued during the year.

Life Insurance Companies—Most life insurance companies reported sharply higher delinquencies and foreclosures from 1982, with peaks in the first and second quarters of 1983. Most reported delinquencies at higher-than-normal rates, with the majority between 5 and 10 percent of the dollar amount of portfolios. A few, however, reported

Table 10
Selected Results by Region and Type of Farming From American Bankers Association 1983 Mid-Year Survey of Farm Credit Conditions
Percent

	Region						Type of Farming					
Survey Question	United States	North-east	Corn Belt	South	Plains	West	Feed/ Food Crops	Dairy	Cow-Calf	Beef Feed-lots	Hogs	Cotton
Farm loan volume delinquent 30 days or more	3.7	3.5	3.5	4.3	3.5	4.5	3.5	3.8	4.5	3.7	3.8	3.9
Farm borrowers who had bank financing discontinued (6/82 to 6/83)	2.9	2.7	2.5	4.4	3.0	3.3	2.7	3.1	3.9	2.2	2.6	3.5
Farm borrowers whom banks anticipate discontinuing (6/83 to 6/84)	2.0	1.8	1.5	2.7	2.6	2.1	1.9	1.9	2.4	1.6	3.7	2.5
Farmers in bank lending area who went out of business (6/82 to 6/83)	2.3	2.0	2.2	3.1	2.4	2.3	2.2	2.6	2.4	1.9	1.9	2.8
Farmers in bank lending area who went through bankruptcy (6/82 to 6/83)	1.07	1.03	1.02	1.88	0.94	1.23	1.00	0.91	1.30	0.47	0.22	0.70
Farm borrowers loaned-up to limit (6/83)	28.0	26.7	26.0	40.5	27.0	32.1	27.0	25.7	32.5	27.8	29.8	33.9
Farm borrowers expected to be loaned-up to limit (6/84)	28.6	27.2	26.2	40.6	28.0	32.2	27.2	26.9	34.5	27.3	29.0	34.6

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lower rates, compared to 1982. Most felt that delinquencies and foreclosures had leveled off and expected improvement over the remainder of the year, and continued, albeit slow progress in 1984.

Repayment rates were reported to be generally about the same to slightly better than in 1982. Most felt that this trend would continue. Extensions and renewals were also reported to be higher. This trend is not likely to continue, however, as extensions are generally made at higher interest rates than the existing one, and borrowers will try to avoid this penalty.

FmHA Credit—The repayment experience of Farmers Home Administration farmer program borrowers slightly worsened during 1983. Over the course of fiscal 1983, the number of borrowers served by FmHA held fairly constant at 271,000. The number of delinquent borrowers increased a substantial 16.0 percent to 77,105, contributing to a yearend fiscal 1983 delinquency rate of 28.4 percent. FmHA delinquency rates are highly seasonal in nature as evidenced by the accompanying chart. Rates are historically much higher in the first quarter of a calendar year, because most loan payments are due on January 1. At the beginning of 1983, the delinquency rate skyrocketed to 52 percent, equalling the record high level of early 1982. The rate was gradually worked down during the year as farmers either repaid loans, discontinued operations, or had their loans rescheduled or reamortized. The lowest delinquency rate recorded in fiscal 1983 was the September level of 28.4 percent, which was significantly higher than the fiscal 1982 low mark of 24.6 percent.

The states exhibiting the most difficult repayment experience in 1983 were the same five states with the greatest number of delinquent borrowers in 1982. Texas (8,568 delinquent borrowers, 50 percent delinquent), Georgia (5,541, 56 percent), Mississippi (4,835, 36 percent), Arkansas (3,533, 29 percent), and Louisiana (3,385, 43 percent) were all affected by spring flooding that severely damaged these states' cotton crops. Depressed income and price conditions in the Southern region also contributed to these significantly higher delinquency rates, which exceeded the rates posted at the end of fiscal 1982.

FmHA Delinquency Rates
Percent of Number of Loans

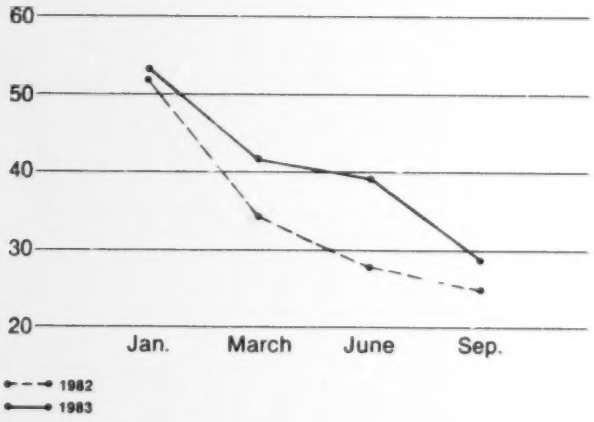

Table 11
FmHA Borrowers and Delinquency Rates by Farm Credit Districts, Ranked by FmHA Delinquency Rates of September 30, 1983

	Number of FmHA Borrowers			Delinquency Rate	
FCS District	Total 9/30/83	Delinquent 9/30/83	Left Farm in FY83*	9/30/83	9/30/82
Texas	16,945	8,568	526	50.6%	45.7%
Columbia	28,734	11,286	864	39.3	33.0
New Orleans	27,748	10,572	999	38.1	34.3
Sacramento	6,006	2,188	186	31.7	29.2
Spokane	12,783	3,644	382	28.5	25.6
St. Paul	30,920	8,097	789	26.2	21.1
St. Louis	32,909	8,522	942	25.9	21.5
Baltimore	16,249	3,967	431	24.4	20.4
Springfield	11,838	2,771	447	23.4	20.2
Wichita	22,502	4,863	490	21.6	19.2
Louisville	27,864	5,962	833	21.4	21.3
Omaha	35,691	6,665	640	18.7	14.3
U.S. Total	**271,089**	**77,105**	**7,529**	**28.4**	**24.6**

*Number of FmHA borrowers who left farming during fiscal 1983 due to financial stress.

The only real positive development in FmHA credit quality was the slowdown in the number of borrowers discontinuing operations due to financial difficulties. By the end of FY 1983, 7,529 farmer borrowers had left farming, a 9-percent decline from the record 8,277 FmHA borrowers who went out of business in 1982. Of the 7,529 discontinuing operations, 18 percent left due to bankruptcy, 18 percent were foreclosed upon, 20 percent voluntarily conveyed their loans to a third party, and 35 percent sold their property through a process other than foreclosure.

During the year, FmHA was faced with a considerably higher number of farmers requesting a rescheduling and/or reamortization of their loans. A total of 30,804 borrowers had one or more loans consolidated, reamortized, or rescheduled, more than double the 12,689 serviced in 1982.

A repayment trend similar to 1983 is anticipated for FmHA borrowers in 1984. As the full impact of the 1983 drought is realized in early 1984 and if county designation of disaster areas is upheld over individual farm designation, many farmers, par-

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ticularly those not enrolled in the PIK program, will experience difficulty in repaying outstanding FmHA loans. Although rescheduling and reamortizing loans provides some relief, some farmer borrowers may be able to minimize their losses if they voluntarily liquidate their operations. Many of those who voluntarily liquidated in 1983, and others who are expected to so in 1984, are severe problem borrowers with high levels of short-term debt; their problems cannot be corrected through existing FmHA servicing authorities. By voluntarily liquidating, they can salvage some capital instead of losing equity while attempting to resist foreclosure.

Financial Conditions of Farmer Cooperatives
Poor performance in the agricultural economy is clearly reflected in the financial performance of the nation's agricultural cooperatives. The record $71.5 billion in combined sales of cooperatives in 1981 fell to $69.2 billion in 1982. Further erosion in business volume is expected to have occurred during 1983. Net margins fell even more dramatically in 1982, dropping almost 41 percent. Weak financial performance for cooperative businesses resulted in the disappearance of 86 cooperatives during 1982. Mergers, consolidations, acquisitions, and liquidations caused the total number of cooperatives to decline to 6,125, and further attrition occurred in 1983.

Cooperatives have not equally shared the burdens of declining sales volume. Cotton, rice, and grain cooperatives were hardest hit. Their business volume declined by about one-fifth during 1982 due to weak commodity prices. Physical volume handled was off sharply during 1983 because of the payment-in-kind program and drought-diminished crop yields. Sales volume, however, reflecting sharply higher commodity prices, could reverse its decline. Farm supply cooperatives, reflecting weakened demand for agricultural inputs, witnessed a substantial drop in sales volume during 1982. Their experience in 1983 will be similar as a result of continued weak demand, reflecting the diminished planting activity of farmers participating in the PIK program.

Sales volumes of dairy cooperatives and cooperatives that process fruits and vegetables contrast with every other cooperative category. Both types of cooperatives registered gains in sales volume of about 8 percent in 1982. Sales volume of the nation's 100 largest cooperatives, representing 57 percent of all cooperative sales, declined 7.4 percent during 1982. The reduction in sales will probably be somewhat less in 1983, and the change may even be positive. Prospects for 1984 are optimistic for sales volume growth among cooperatives.

The net worth of cooperatives showed only slight erosion during fiscal 1982. The success cooperatives had in reducing liabilities accounts for this performance, a reduction that almost equally offsets the reduction in total assets. Current assets, reflecting lower commodity prices for the period, showed a decline during fiscal 1982. Investment in physical plant, however, grew, reflecting improvements made in production facilities. Higher commodity prices in 1983 likely bolstered current asset values by offsetting lower inventories. The prospects for higher asset values among agricultural cooperatives were good for 1983.

The capacity of the 100 largest cooperatives to prevent erosion of balance sheet strength is shown by the ratio of current assets to current liabilities. The current ratios remained constant at 130 percent between the beginning of the 1982 and the 1983 fiscal years. This performance is especially commendable in view of erosion in the quality of accounts receivable during the period.

Table 12
Composite Balance Sheet for Largest 100 Co-ops at Beginning of Fiscal Years 1982 and 1983

Item	1982	1983
Assets:		
Current assets	9,991	9,379
Non-current assets		
Investments	1,573	1,695
Property, plant and equipment	5,073	5,742
Other assets	593	284
Total	**17,230**	**17,100**
Liabilities and Net Worth:		
Current liabilities		
Short-term debt	3,201	3,089
Other liabilities	4,459	4,144
Non-current liabilities		
Long-term debt	4,052	4,377
Other liabilities	381	359
Total liabilities	12,093	11,969
Net worth	5,137	5,131
Total	**17,230**	**17,100**

Total debt rose about 3 percent during fiscal 1982. The total debt-to-equity ratio rose to 146 percent during 1982, an increase of about 5 percentage points from the previous year. The increase is amplified by the failure of equity values to rise. Reflecting the experience of the previous year, cooperatives increased long-term debt while decreasing their reliance upon short-term debt.

Sources of Debt Capital for Large Cooperatives—The most dramatic changes in sources of debt

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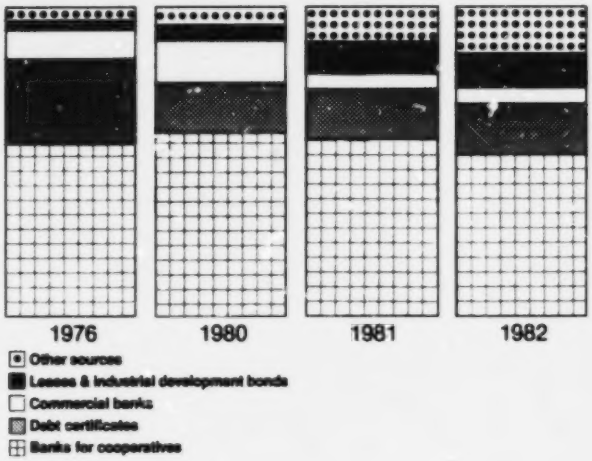
Sources of Debt Capital for Large Cooperatives
Percent of total debt capital



capital for cooperatives since 1970 has occurred in the "other sources" category. This category includes borrowings from insurance companies, other nonfinancial businesses, the Commodity Credit Corporation, miscellaneous sources, and the use of commercial paper. Of these sources, life insurance companies are the most important, holding 4.2 percent of cooperative debt in 1982. Sales of commercial paper by cooperatives showed the largest growth in this category. This source of financing, relied upon mainly by the largest cooperatives with high credit ratings, grew to 3.2 percent of debt capital in 1982.

Use of industrial development bonds was almost equal to use of capitalized leases as sources of debt capital for cooperatives in 1982. Both stood at just under 5 percent of total debt capital, with the slight growth in the importance of this category being due to somewhat heavier use of development bonds. The growth of these forms of financing was equal to the slight rise in the proportion of debt obtained from debt certificates. These are often sold directly to members.

Commercial banks maintained their share of the debt capital of large cooperatives at 5.9 percent of total debt. Commercial banks are more important as sources of short-term debt. The greatest change in the composition of large cooperatives' debt capital, both for relative share and for absolute dollar amount, occurred in borrowings from the banks for cooperatives. Although BCs remain the largest single source of debt capital for large cooperatives, providing just over half in 1982, their share has moderately declined over the past 3 years. Since 1970, the reduction in importance of BCs as sources of debt capital for large cooperatives has been even more significant. Banks for cooperatives are relatively more important as sources of long-term debt capital for cooperatives than they are as sources of short-term debt.

Prospects for 1984—Considerable optimism exists for the financial performance of cooperatives during 1984. Reductions in stocks of basic agricultural commodities during 1983 have greatly strengthened prices as the new year begins. Planted acreage is expected to be large as farmers seek to benefit from what is widely perceived as a strong upward trend in prices. As a consequence, demand for farm supplies will likely be strong. Sales volumes and earnings of agricultural supply cooperatives will benefit. A major portion of the anticipated higher earnings will likely be used to retire debt. The resulting strengthening of the balance sheet of those cooperatives able to do so will reverse the erosion in the financial condition of cooperatives, a disquieting trend that has marked the past 3 years.

The optimistic outlook for the financial performance of cooperatives during 1984 depends on strong commodity prices for the entire year. Whether this occurs will depend on the size of the 1984 harvest. Strong prices at the beginning of the year are expected to encourage a large crop. Should the prospects for a large harvest in excess of domestic requirements become increasingly probable as the year progresses, considerable softening of commodity prices could occur. Export demand is expected to remain weak and thus will not contribute strength to commodity prices. Should prices soften, a possibility that could occur as early as mid-year, earnings of marketing cooperatives could decline. With the probability of this scenario subject to considerable debate, prospects for the financial performance of cooperatives during 1984 remain optimistic for farm supply organizations, but more uncertainly so for marketing cooperatives.

Lender Activity

Farm Credit System Lending

The slowdown in System lending activity that began in the middle of 1982 continued into 1983. System loans made during fiscal 1983 were $64.4 billion, 5.8-percent less than in 1982. After several years of double-digit growth in outstandings, the System experienced an 0.5-percent decline in the level of outstandings for the year ended September 30, 1983. Loan growth was restricted by slow turnover in agricultural land sales, reduced demand for farm machinery because of weak farm income,

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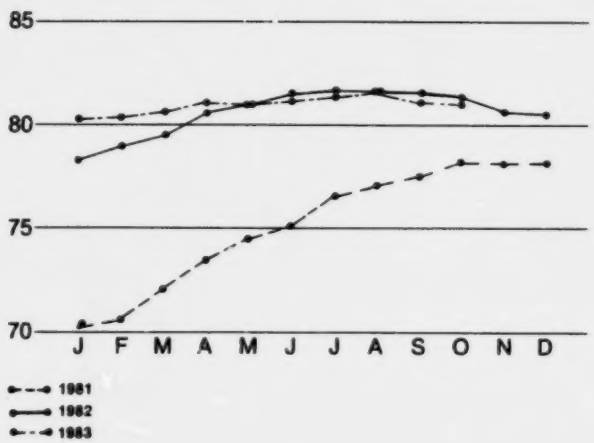
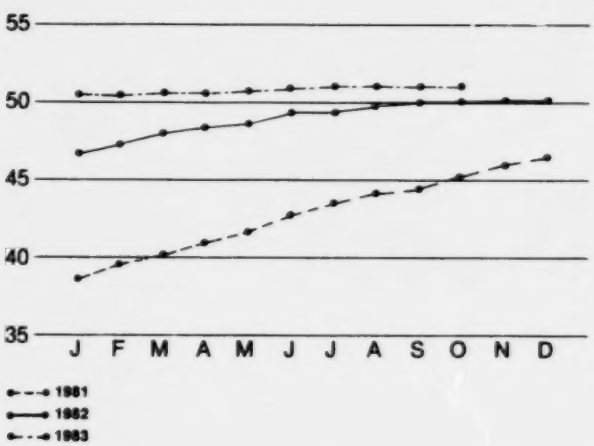
FCS Loans Outstanding, 1981-83
$ Billions



FLB Loans Outstanding, 1981-83
$ Billions



high participation in the acreage-reduction and PIK programs, and increased lending competition from commercial banks.

FLBs—After averaging 19 percent per year over the last decade, growth in FLB outstandings slowed to a 2.2 percent annual rate for the year ended September 30, 1983. Loans made during the year declined 43.7 percent from fiscal 1982 loan volume, following a 22.8-percent decline in 1982. A decline in land values, coupled with weak loan demand, has contributed to depressed real estate loan demand for all agricultural lenders.

All FLBs posted significantly stronger repayment rates for the first 9 months of calendar 1983, compared with the same period a year ago. The FLB repayment rate climbed to 87.6 percent from 70.9 percent a year earlier. These gains reflect the impact of Government commodity programs on cash flows, loan servicing actions, and declining new loan volume.

The FLB refinancing of nonreal estate debt declined slightly to 15 percent of farm loan funds from 17 percent in the first 9 months of 1982.

PCAs—At the end of 1982, the PCAs recorded a 4.4-percent reduction in loans outstanding, the first annual decline in 28 years. The retirement of 83 million acres of farmland under the PIK and acreage-reduction programs impeded chances of significant recovery in loan demand. As of September 30, 1983, PCA loans outstanding were $20.5 billion, a 9.1-percent decline from a year earlier, and a return to the same level as September 1980. Loans made during the year were down 8.8 percent from 1982 loan levels.

The PCA collection rate for the first 9 months of 1983 was 80.3 percent of the 1978-80 average, compared to 91.5 percent a year earlier. PCA renewals accounted for a moderately larger share of PCA loans made, compared with 1982 levels. Renewals claimed 33.7 percent of PCA loans

Table 13
Volume and Market Share of Farm Real Estate Debt Outstanding by Lender, January 1, Selected Years 1970-1984*
$Billion and Percent

Year	Total		FLB		FmHA		Life Insurance Companies		Commercial Banks		Individuals and Others	
1970	$ 29.2	100%	$ 6.7	22.9%	$2.3	7.9%	$ 5.7	19.5%	$3.5	12.0%	$11.0	37.7%
1975	44.6	100%	13.4	30.0	3.2	7.2	6.3	14.1	6.0	13.4	15.8	35.3
1980	85.4	100%	29.6	34.7	7.1	8.3	12.2	14.3	8.6	10.1	27.9	32.6
1981	95 5	100%	35.9	37.6	7.7	8.1	12.9	13.5	8.7	9.2	30.2	31.6
1982	105.5	100%	43.6	41.3	8.7	8.3	13.1	12.4	8.4	7.9	31.8	30.1
1983p	109.5	100%	47.2	43.1	9.1	8.3	12.8	11.7	8.4	7.7	32.0	29.2
1984f	111.9	100%	48.2	43.1	9.5	8.5	11.4	11.4	9.1	8.1	32.3	28.9

*Debt includes that of operator households
r = revised p = preliminary f = forecast

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Table 14
Volume and Market Share of Farm Nonreal Estate Debt Outstanding by Lender, January 1, Selected Years 1970-1984*
$ Billion and Percent

Year	Total		Commercial Banks		PCAs		FICB-OFI		FmHA		CCC		Individuals and Others	
1970	$ 23.8	100%	$10.3	43.3%	$ 4.5	18.9%	$.2	.8%	$ .8	3.4%	$ 2.7	11.3%	$ 5.3	22.3%
1975	37.0	100	18.2	49.3	9.5	25.7	.4	1.1	1.0	2.7	.3	.8	7.5	20.3
1980	80.4	100	31.0	38.6	18.0	22.4	.7	.8	9.0	11.2	5.1	6.3	16.6	20.7
1981	86.4	100	31.6	36.5	19.6	22.7	.8	.9	11.8	13.6	5.0	5.8	17.7	20.5
1982	96.1	100	32.9	34.3	21.0	21.9	.9	.9	14.5	15.0	8.0	8.3	18.8	19.6
1983$_p$	106.8	100	36.1	33.8	20.1	18.8	.9	.8	14.8	13.8	15.4	14.4	19.5	18.3
1984$_f$	103.1	100	38.5	37.3	18.9	18.3	.8	.8	15.6	15.1	10.4	10.1	18.9	18.4

* Debt includes that of operator households
p = preliminary f = forecast

closed during the first 9 months of 1983, against 32.8 percent a year earlier. A portion of this increase was caused by the decline in the volume of loans made.

BCs—The BCs posted a significant improvement in loan volume, as loans closed during the fiscal year increased 13.4 percent from 1982 to $27.15 billion. The level of loans outstanding between September 30 of 1982 and 1983 increased 7.8 percent. However, on September 30, 1983, BC outstandings of $8.71 billion were 2.7 percent below September 1981 outstandings.

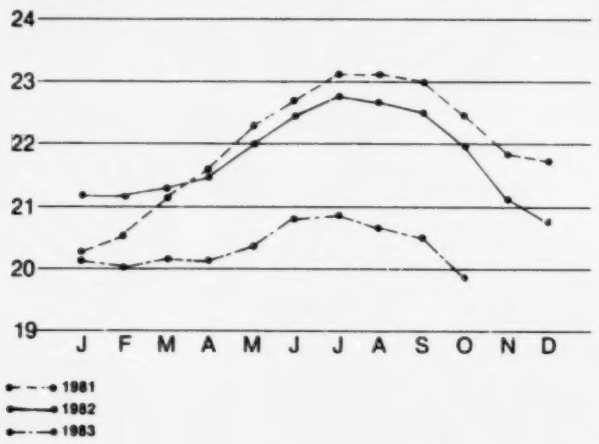
The BC repayment rate at 121.2 percent was sharply above the 1978-80 average, as well as the year earlier figure of 103.4 percent.

FICB/OFI—As measured by the loan-deposit ratio, agricultural commercial banks are on average in the most liquid lending position in 7 years. As a consequence, demand for the System's lending program for other financing institutions has been greatly diminished. Loans closed during fiscal 1983 declined 15.2 percent to $1.62 billion from $1.91 billion in 1982. Outstandings on September 30, 1983, were down 6.2 percent from a year earlier.

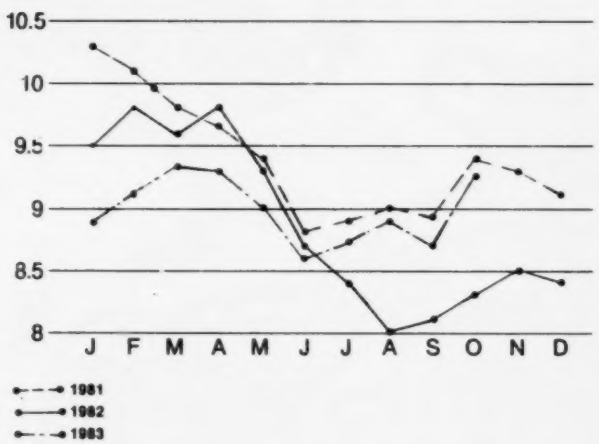
Farm Credit System Funding
The Farm Credit System relies heavily on the capital markets as its source of funds for financing lending operations. All three parts of the System managed to take advantage of the break in short-term rates that occurred in the first half of 1983 and reduced their average bond portfolio costs. However, continued weak demand for both real estate and production credit limited the System's financing needs and contributed to the first calendar year paydown of the System's bond portfolio in recent history.

For all of 1983, the System's maturing obligations exceeded its new obligations by $2.8 billion. This paydown of the portfolio follows $1.9 billion in new

PCA Loans Outstanding, 1981-83
$ Billions



BC Loans Outstanding, 1981-83
$ Billions



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money raised in 1982 and annual average net changes in the portfolio of $10 billion or more in the 1979-81 period.

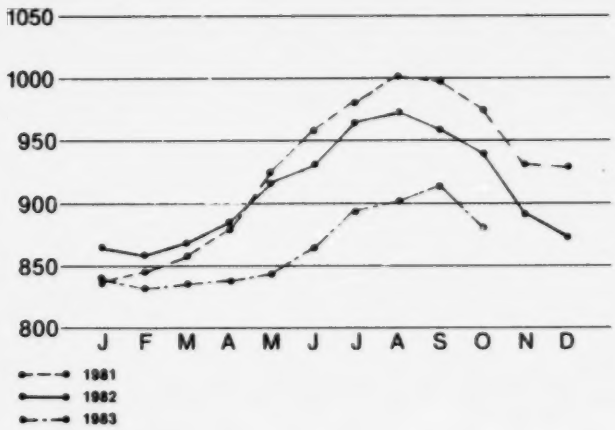
Short-term bonds issued during the first quarter of 1983 carried rates between 8.5 and 8.75 percent, considerably lower than the 1982 peak rate of 14.65 percent at the end of the second quarter. Unlike the past 3 years, System short-term bond rates displayed minimal volatility during 1983. In the first half of the year, the short-term rate remained at or below 9.25 percent. Towards the end of the summer, rates increased to a little above 10 percent for a brief period and then fell to between 9 and 10 percent for the balance of the year.

Because of the absence of major fluctuations in interest rates during 1983 and the stance adopted by the Federal Reserve, short-term rates on new issues averaged 360 basis points lower in 1983 than in 1982. Average interest rates on the $28.6 billion in new short-term obligations issued was 9.2 percent in 1983, compared to 12.8 percent in 1982. In all, the System's short-term bond portfolio declined $4.1 billion from 1982. However, a growing share of the System's short-term financing needs were accommodated by the discount note program in which outstandings increased approximately $2 billion during the year.

Because of the preponderance of short-term bonds in the FICB portfolio, the FICBs lowered their average funding costs from the yearend 1982 level of 11.74 percent to 10.26 percent on December 1. Over the same time frame, the BCs lowered their average cost from 10.97 to 10.69 percent.

In the term-bond market, the System issued $7.5 billion in new obligations bearing a weighted average cost of 10.6 percent. Throughout 1983, the term-bond portfolio grew by an historically low volume of $1.2 billion, and there was a 300 basis-point reduction in average term-bond funding costs. For the first time since July 1980, term-bond rates dropped to below 10 percent at the beginning of 1983. Between February and August 1983, term rates hovered around the 10 to 11 percent range and completed the year between 11 and 12 percent. Because the FLB portfolio is comprised largely of term issues and term-bond rates were slower to fall than short rates, the FLBs experienced only a 6 basis-point reduction in their average cost of funds, which fell to 11.82 percent.

FICB Loans Outstanding to OFIs, 1981-83
$ Millions



As the economic recovery continues to moderate in early 1984, Treasury rates are expected to ease slightly during the first half. By the end of the year, the financing needs of the Treasury could potentially choke off the credit demands of the private sector, forcing rates up slightly. Because System security rates follow the general pattern of rates on new Treasury issues, all three Systems' average funding costs by yearend 1984 should be within a narrow range from the average portfolio costs at the end of 1983.

Commercial Banks, Lending and Funding

Throughout the first half of 1983, agricultural commercial banks were in the most liquid lending position in 7 years as measured by the average loan-deposit ratio. For the reporting period ending the second quarter of 1983, the ratio registered 58.9 percent, up slightly from the first quarter level of 57.2 percent, but down from 60.2 percent registered just 1 year ago.

Perhaps the greatest contributing factor to banks' strong liquidity position in 1983 was the introduction and initial mass appeal of the money market deposit accounts (MMDAs). MMDAs are by far the most popular depository account to be introduced by commercial banks when compared to any other post-deregulation deposit instrument. When MMDAs were first offered in December 1982, banks offered attractive above-market introductory rates on accounts with minimum deposits of $2,500. Within the first month, all savings institutions attracted $119.8 billion in funds, $73.5 billion of which were held by commercial banks. Although a large percentage of these funds were transferred from the banks' 5.25 percent passbook savings accounts or maturing certificates of deposit, about 40 percent of the money came from outside the banks, including $56 billion in deposits transferred from the money market mutual funds. By the end of April, MMDAs held by all commercial banks had risen to and leveled off at the $200 billion mark, and all depository institutions had $347 billion on deposit. Despite this ready source of lendable funds, the commercial banking sector as a whole

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Table 15
Composition of Liabilities of Commercial Banks by Size and Location, June 30, 1982 and 1983
(Percent of Totals)

Liabilities	Very Small Rural Banks[1]		Large Rural Banks[2]		Large Metro Banks[2]		The Largest 22 Banks[3]	
Core Deposits:	**1982**	**1983**	**1982**	**1983**	**1982**	**1983**	**1982**	**1983**
Demand deposits	19.0	16.5	17.6	15.7	22.9	21.2	14.7	13.9
NOW accounts	6.8	7.0	6.3	6.4	5.7	5.8	1.7	1.5
Regular savings accounts	11.8	10.0	15.4	13.7	15.2	14.5	3.9	3.6
Super NOW + MMDA	na	8.2	na	11.3	na	11.5	na	4.5
Money market certificates	32.2	28.8	26.6	22.3	20.5	16.4	4.1	2.5
Other time deposits < $100,000	20.7	20.3	17.7	17.6	13.2	13.0	2.8	2.4
Total	**90.5**	**90.8**	**83.6**	**87.0**	**77.5**	**82.4**	**27.3**	**28.4**
Volatile Liabilities:								
Time deposits >$100,000	8.1	7.7	10.9	8.6	14.2	11.0	18.6	16.5
Deposits in foreign offices	0	0	0	0	0	0	30.8	29.6
Federal funds & repurchase agreements	0.2	0.1	3.3	2.4	5.9	4.3	10.5	16.1
Acceptances & Other Borrowing	1.2	1.5	2.2	2.0	2.4	2.2	12.8	9.3
Total	**9.5**	**9.2**	**16.4**	**13.0**	**22.5**	**17.5**	**72.7**	**71.5**

na = not applicable
[1]Assets = $10-25 million
[2]Assets = $100-300 million
[3]Assets = $10 billion or more

had a difficult time converting these funds into profits. Many bankers were hoping that as the economic recovery gained momentum, loan demand would in turn gain steam. Because so many banks were hesitant to tie up money in long-term loans and with real interest rates continuing at historically high levels, loan demand at most commercial banks has fallen short of expectations.

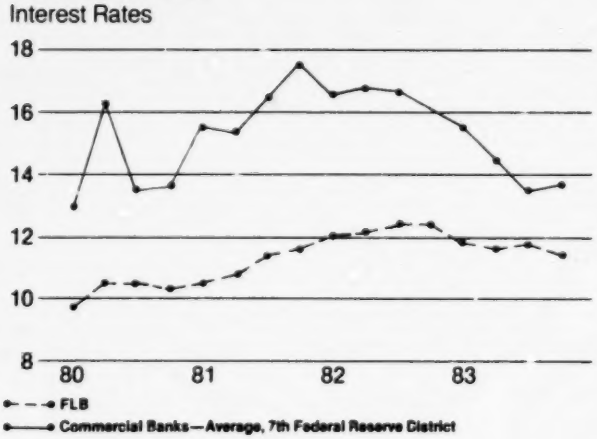
Rural banks continue to be heavily dependent on small denomination accounts as their primary source of funds. Like other commercial banks, rural banks derived about 8 to 11 percent of their liabilities from the MMDAs and Super NOW accounts by mid-1983. Within rural banks, many funds were shifted from demand deposits and money-market certificates. Similarly, the disintermediation of funds from the money market mutual funds and the high level of their funds concentrated in large bank CDs caused all banks to experience a decline in $100,000 time deposits.

Despite the prevalence of weak loan demand at most commercial banks, agricultural commercial banks increased their farm loans outstanding by a healthy 7.2 percent for the year ending June 30, 1983. Over the same time period, both the Farm Credit System and life insurance companies experienced decreases in their outstandings by 0.5 and 2.5 percent, respectively.

One explanation for the improvement in agricultural banks' outstandings relative to the System can be related to the pricing structures inherent to both lenders. Because the System bases its loan rates on the average cost of funds and commercial banks practice marginal pricing, the System tends to have a competitive interest rate advantage over banks when rates are rising. As rates decline, the System's competitive edge in the interest rate differential diminishes and can, in fact, reverse.

As an example, at the end of 1981, when interest rates were approaching record levels, the average rate on commercial bank operating loans in the Chicago Federal Reserve district had risen to 17.4 percent. Because the System averages its higher-priced bonds with its lower-priced issues in deter-

FLB Lending Rates vs. Commercial Bank Real Estate Rates



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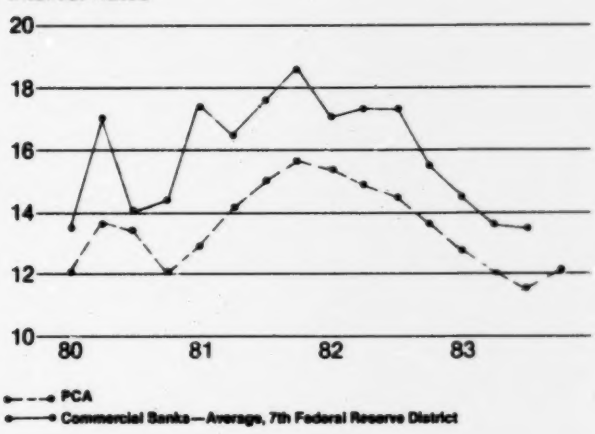
mining its cost of funds, the System had not yet been significantly affected by increasing funding costs. Therefore, PCA rates were slower to rise and remained significantly lower at 12.9 percent. Conversely, when rates declined at the end of 1982 and early 1983, the commercial bank loan rate was worked down to 13.7 percent and the PCA rate to 12.0 percent, a much narrower gap than in the earlier period of increasing interest rates.

PCA Lending Rates vs. Commercial Bank Nonreal Estate Rates



In 1984, commercial banks will rely more heavily on other financial services as a means of deploying funds and boosting profits. On the deregulation agenda for 1984, commercial banks will lobby for the authority to expand into the brokerage of insurance, real estate, and securities. Deregulation is also encouraging interstate mergers of banks, despite Federal laws that generally prohibit out-of-state acquisitions. Many bankers believe that interstate banking is inevitable in the near future, because they are currently circumventing restrictions by providing financial services across state lines. The sentiment among bankers is that current restrictions are now damaging banks' profitability, more than protecting them from outside competition.

One event that could have a dampening effect on commercial bank liquidity in 1984 is the potential outflow of funds, as billions of dollars in individual retirement accounts continue to mature. At the beginning of 1982, all wage earners became eligible for IRAs and $10 billion poured into accounts in the first quarter alone. Because IRAs have a minimum maturity of 18 months, many of the earliest accounts are beginning to mature. At the time these accounts were established, interest rates were at post-World War II record highs. During 1984, a growing number of investors will be faced with the decision of whether to roll over these funds with the commercial bank at a considerably lower rate or to transfer their funds to stock funds or another potentially higher yielding asset.

An aspect of the MMDAs and Super NOW accounts that merits attention is the fact that these new deregulated accounts have only been in existence during a period marked by declining interest rates. The forecast for 1984 is for continued moderation in short-term rates. However, the banks' growing dependence on deregulated accounts as a source of funds could apply pressure on lending rates and severely hamper bank profits if a new round of inflation is experienced.

Life Insurance Company Lending

In response to the general distress of farm borrowers, life insurance company debt outstanding declined from $13.1 billion in the fourth quarter of 1981 to $12.8 billion by the fourth quarter of 1982, a 2-percent drop. The first quarter of 1983 saw a further decline. Outstandings recorded a small increase in the second quarter, although they were still 2 percent below the year-earlier figure. The "bottoming-out" in the first half of the year was reinforced by trends in life insurance company new farm mortgage commitments. After declining for 12 straight quarters from 1980 through 1982, the 4-quarter moving average of new commitments showed positive change over the first two quarters of 1983. Additionally, individual life insurance companies reported commitments and closings up significantly from 1982.

Life insurance companies generally have an ample availability of funds for borrowers able to generate good cash flows. Most insurance companies have established rather stringent lending criteria requiring interest rates in excess of 12 to 13 percent, a figure that many farm operators have had trouble meeting in the last few years. These lending restrictions will limit the near-term growth of life insurance company lending, unless alternative long-term sources of funds are found that involve less interest risk. A possible source is being tapped by a new subsidiary of Prudential, designed to raise funds specifically for agricultural lending by marketing new financial securities.

Commodity Credit Corporation Activity

Compared to most lenders, CCC loans outstanding can vary widely depending on the borrowers' motives. For example, when the interest rate on CCC loans falls below those charged by other lenders, farmers and their cooperatives use CCC nonrecourse crop loans as a source of short-term financing. When this happens, it can affect PCA

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and BC loan volume. On the other hand, when crop prices fall below the CCC loan rates, the loans are used as a marketing device to effectively shield excess supplies from the market, thereby supporting prices. CCC is also an instrument of Government policy, because farmer eligibility requirements can be used to influence participation rates in commodity programs. Participation rates ultimately affect production levels and the amount of direct payments to farmers.

This mixing of roles often results in wide swings in CCC lending activities, but at no time has the swing been more dramatic than in the past year. During the fourth quarter of 1982, CCC loans outstanding increased over $5 billion, followed by another $2.7 billion in the first quarter of 1983. At one point last winter, total loans outstanding were close to $20 billion, which compares with $15.4 billion and $8.0 billion at the end of 1982 and 1981, respectively.

The large gains in CCC loans outstanding during most of 1982 and early this year reflected burdensome grain stocks, low commodity prices, and liberalized rules for putting grain directly into the farmer-owned grain reserve. Since March, however, CCC loans outstanding have tapered off as farmers increased their redemption rates and also as PIK distributions were made to farmers. By the end of 1983, CCC loans outstanding are believed to have been close to $10 billion—as of August 31, the figure was $14.4 billion.

Market shares of nonreal estate debt held by reporting institutions have shifted significantly over the past 2 years, with CCC loan activity accounting for a large part of the change. Traditionally, CCC loans have seldom represented more than 10 percent of this market, but with the explosion in loan activity since 1981, the CCC market share reached 20 percent by the end of the first quarter in 1983. Interestingly, this share was only slightly smaller than that held by the PCAs. The reversal in CCC loan activity during the second half of 1983 has resulted in some loss of market share, a gap that is largely being filled by commercial banks.

As a source of short-term financing, CCC loans will continue to be an important source of credit in 1984. However, after holding center stage for the last two years, CCC's role in the year ahead is expected to be far less significant than it was in the 1981-83 period. CCC will also continue to play an important role in 1984 as a residual market for excess grain. But its prominence will be less apparent because of the massive liquidations of grain stocks—reflecting the 1983 drought and the PIK program—and also because of the prospects for lower farmer-participation rates in the 1984 commodity programs.

The factors that will largely determine CCC loan activity in the year ahead are: (1) the CCC interest rate relative to those of other lenders; (2) future price trends for those farm commodities eligible for CCC loans; and (3) the base acreage that is ultimately enrolled in the 1984 commodity programs. CCC bases its interest rates to borrowers on the average cost of its borrowings from the Treasury. For new loans, the rate in a given month reflects the average cost of 12-month Treasury issues during the 4- or 5-week period ending around the 20th of the prior month. In 1983, these monthly rates for new loans varied from 8 5/8 percent to 10 1/2 percent.

For existing loans outstanding at yearend, the CCC interest rate established in January remains in effect for the full year, unless the loan is redeemed or the interest is waived under one of the reserve programs. In 1983, this rate was fixed at 9 percent, a very attractive rate when compared to those charged by other lenders. The January 1984 interest rate for existing loans will probably increase somewhat from the year-earlier figure if Treasury rate developments in November and December materialized as expected. A rate near 10 percent seems likely. Thus, CCC interest rates probably will not be as attractive to farmers and farmer cooperatives as they were in 1983, vis-a-vis other lenders.

A continuation of strong prices into the signup period for 1984 commodity programs could discourage participation and invite a return to all-out production, thereby setting the stage for bumper crops and low prices later in the year, given normal growing conditions. Thus, many farmers—especially those in a vulnerable financial position—may view the 1984 commodity programs as a source of price protection, although forward sales may have offered a better solution.

How farmers ultimately respond to the new programs is still a big unknown for 1984. Most of the evidence points to a drop in participation levels, which means that CCC loans outstanding at yearend probably will not be large. In the intervening months, total loans outstanding will likely decline seasonally.

Two "bottom-line" conclusions derive from this discussion. First, CCC loans are typically more closely aligned with marketing decisions than they are with production-borrowing decisions by farmers. Although wide swings in CCC loan activity impact the market shares of all lenders, the

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loans outstanding at commercial banks and PCAs probably are not that much higher or lower than they would be otherwise. For the BCs, however, what the CCC does can make a difference; it can also make a big difference for the farm borrower who needs short-term financing. The second conclusion is that 1984 likely will be a year in which commercial lenders experience a huge surge in credit demands, not because of diminished CCC loan activity, but because of a return to a higher level of crop production.

FmHA Lending

Farmers Home Administration lending activity in its four major farm programs fell considerably short of budget levels in fiscal 1983. This occurred primarily because of an overestimate of emergency disaster lending and the continued impoundment of funds in the economic emergency program. Overall reductions in FmHA lending activity reflect the intent of the Administration to reinforce FmHA's original mission as a lender of last resort and the gradual replacement of disaster loans with crop insurance. Within the four farmer programs, fiscal 1983 outlays were $3.0 billion, significantly lower than the $4.0 billion obligated in 1982 and $8.0 billion in 1981. These four programs constitute a little more than 46 percent of FmHA's total 1983 direct and guaranteed loan volume of $6.3 billion.

The overestimate in the emergency disaster program (EM) occurred because of the high degree of difficulty in projecting the impact weather conditions will have on crop output. Despite the severe drought that affected widespread sections of the country, only $566 million in EM funds were loaned in 1983 due to the administrative lags involved in declaring counties disaster areas. During fiscal 1983, FmHA handled 14,605 requests for EM loans of which 10,095 or 69 percent were approved. Accounting for a little more than one-half of the EM loan activity were five Southern states that were severely hampered by spring flooding: Texas (1,503), Georgia (1,035), Mississippi (980), North Carolina (873), and Louisiana (791).

Table 16
FmHA Loans Made by Program, Fiscal 1982 and 1983, and 1984 Budgeted Levels
$ Million

Program	1982	1983	1984
Farm ownership	658	730	625
Farm operating	1,204	1,785	1,810
Emergency disaster	2,173	566	1,540
Economic emergency	0	0	600
Total	**4,035**	**3,081**	**4,975**

Emergency loan applications following a drought usually are filed well into the spring of the next crop season. Therefore, FmHA expects EM loan activity to approach the budgeted level of $1.54 billion in 1984. As of mid-October, nearly 400 counties in eight states were designated as eligible for emergency loans because of drought-related losses. If the method of determining qualification for disaster loans is changed from a county designation to individual farm designation, and there is currently much pressure to do so, FmHA officials estimate that loan volume could reach nearly $3 billion in 1984. In October, FmHA lowered its EM loan rate to farmers unable to obtain credit elsewhere to 5 percent from 8 percent on the first $100,000 borrowed.

Although $600 million in economic emergency (EE) funds were appropriated by Congress in 1982 and 1983, no EE loans were made during these years. EE loans are designed to help farmers overcome economic hardship caused by credit scarcity or cost-price squeezes beyond their control. Under law, EE funds are available only at the discretion of the Secretary of Agriculture. Despite the occurrence of depressed commodity prices, Secretary Block told Congress in 1981 that the EE program was no longer needed, because he felt that ample credit was available from commercial banks and the Farm Credit System. Last September a Federal judge ruled that the Secretary's decision to withhold EE funds in FY 1982 was "arbitrary, capricious, and an abuse of his discretion." In October 1983, the court ruled that USDA must operate the EE program through September 30, 1984. Eligible borrowers can borrow up to $400,000 at a rate of interest equal to the cost of money to the Government.

Despite an abundance of liquid funds at commercial banks and declining loan volume at PCAs, most lenders continue to exercise caution in extending new operating loans to farmers. As a result, demand for FmHA operating loans (OL) increased considerably in 1983. At the beginning of the fiscal year, $1.46 billion in OL loans was appropriated for farmers and ranchers lacking other sources of production credit. During the year, FmHA received 85,592 requests for OL loans, a 35-percent increase from the 63,636 requested in 1982. Total loans approved in 1983 amounted to 59,579, compared to 42,875 in 1982, a 39-percent increase in the number of borrowers served. Because of this unanticipated surge in lending activity, FmHA exhausted its lending authority for OL loans 8 months into the fiscal year. In order to accommodate borrowers the balance of the year, $325 million in unencumbered funds from other FmHA loan programs was transferred to the OL

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program and nearly all of the $1.785 billion budgeted was obligated by yearend. Accounting for 27 percent of OL loans granted were Texas (4,531), Louisiana (3,148), Iowa (3,130), Missouri (2,879), and North Carolina (2,541). For fiscal 1984, FmHA expects loan activity to be comparable to 1983, and it has authority for $1.81 billion in insured loans, 1.4 percent higher than 1983 loan volume.

Demand for FmHA farm ownership loans (FO) also increased substantially, increasing by 29 percent to 36,455. Of the farmers requesting loans, 10,660 were approved and/or granted loans. Additional funds were transferred to the FO program late in the fiscal year. Total obligations amounted to $730 million, exceeding the initial appropriation by $30 million. Many FmHA farm ownership loan applicants remain highly leveraged, as evidenced by a debt-to-asset ratio of 59 percent for initial FmHA ownership loan applicants. The 1984 budget allows for $625 million in FO loans, slightly lower than 1983 loan volume.

Lender Responses in 1984

Reduced repayment capacity, weak real estate markets, and shrinking net worths are the major factors driving lenders' responses to current agricultural conditions. These factors are resulting in higher delinquency rates, more adversely classified loans, increased servicing efforts, greater foreclosure activity, and reduced new business. Nevertheless, the reaction of lenders has been much more stable than economic conditions would suggest.

Despite the hardships of the last several years and the uncertain outlook for the future, most lenders continue to be committed to working with farmers. This support is strongest for borrowers who:

1) are doing their best to make their operation productive;
2) are properly applying proceeds (if any) of their production;
3) are taking care of their property;
4) are complying with the terms of their loan agreements; and
5) are capable of eventually working their way out of the existing debt burden.

Borrowers are not being denied sound credit because of temporarily insufficient repayment income. In fact, for those operations deserving credit, funding will be readily available as competition in the agricultural lending market increases.

Lenders have responded to the current challenges by applying existing loan servicing tools with greater efficiency. In general, the existing servicing programs and techniques have been found to be adequate and effective when applied in a timely and consistent manner. For Federal land bank associations and PCAs, the traditional tools include extensions, deferments, reamortizations, and other methods to restructure debt.

Although lenders continue to rely on proven lending criteria, cash flow analysis and financial position are playing increasingly important roles. The ability of the operation to service debt and meet operating needs, the quality of the collateral, and the lenders' position in collateral will be weighed very carefully as loan packages are analyzed in the next several years.

In the short run, creditors have some additional avenues to minimize their risk exposure. This can be accomplished by working with borrowers and encouraging them to participate in Government programs, use forward-contracting, liquidate nonproductive assets, increase their off-farm income, and possibly renegotiate leases. This last item can reduce borrower risk by shifting it to the landlord, who in many instances is less highly leveraged.

In addition to these tools, programs, policies, and strategies, the survival of many borrowers will hinge on hard work and concern by everyone involved. Weaker loans will require constant supervision, frequent reporting, and open lines of communication between the lenders and borrowers.

Long-range responses by agricultural lenders must take into account changes in the market. Agriculture has experienced significant changes over the past few years, and indications are that it will continue to become increasingly complex and sensitive. Financing agricultural operations will need to reflect these changes. The key will be tailoring services to meet the needs of individual borrowers. To do this, it will be necessary to expand loan servicing requirements and use to the fullest all available policies, procedures, and techniques. It will also be imperative that policies and procedures be reviewed and updated frequently to fully serve creditworthy farmers.

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IV. OUTLOOK FOR COMMODITIES

Major variables shaping the crop price outlook for 1984 are flashing a caution signal: favorable prices early in the year, coupled with relatively ineffective Government acreage-control programs, raise the prospect of a price depressing abundance at harvest time. However, 1983/84 ending stocks are expected to be greatly reduced for several major crops, and weather in the 1984 growing season will be a crucial variable in determining new crop prices. For livestock, the demand outlook is brighter than it has been in more than 3 years. On the livestock supply side, recent breeding stock adjustments, for hogs in particular, appear to be setting the stage for prices in the meat-and-poultry complex to improve by midyear.

The combined impact of the payment-in-kind (PIK) program and the severe drought experienced in much of the nation during the past year will continue to be felt in both the crop and livestock sectors during 1984. The 1983 drought differed from the relatively recent ones of 1974 and 1980 in that this one hit harder into the heart of the Corn Belt, and it persisted over an ever-expanding area through the latter part of the growing season. Pasture and range conditions on July 1 were rated at 88 percent—significantly above the 31 percent July 1 average for the 1972-81 comparison period. By August 1, the overall rating had fallen to 76, still a point above the 10-year base, but conditions had worsened in 43 states. The deterioration continued in 38 states during August, bringing the overall average rating down to 63 percent—11 points below the base and 19 points under the September 1, 1982 mark. Moisture conditions rapidly returned to normal in most affected areas during the fall.

Farm prices for most program crops should remain well above support levels for much of the current marketing year. From the principal growing season into harvest, prices are expected to be extremely sensitive to new crop-growing conditions. The direction of feed grain prices after midyear will set the tone for livestock producers. The trend in feed costs during the third quarter will likely determine whether producers begin to slowly expand their herds or to resume liquidation. The odds seem to favor large crops, improved livestock profitability, and eventual moves toward breeding herd expansion.

Total meat and poultry production is expected to decline somewhat in 1984, though the culling of dairy animals could alter this prospect. Pork producers have liquidated some breeding stock in recent months and appear to have scaled down their farrowing plans from year-earlier levels. Beef cattle numbers have apparently continued to edge downward, and broiler producers have reacted to negative profit margins by cutting back the number of pullet-chick replacements for the hatchery supply flock, thereby increasing the average age of the flock and perhaps slowing their supply response time. Unfortunately, dairy producers are expected to be cutting their herds during 1984, in response to high feed costs and changes in the Government dairy program. The degree and timing of expected dairy-herd liquidation will be a key factor influencing potential price strength for all red meats and poultry.

With favorable crop growing conditions and moderate dairy-cow culling, choice fed steer prices are expected to rise from the low 60s to around 70 dollars per cwt by midyear and then settle back to the mid-60s by yearend. Hog prices are expected to rise from the mid-40s in the first quarter to the mid-50s in the latter part of 1984. Broiler prices could rise from a wholesale price range of 46 to 50 cents per pound in the first quarter to the low 60s in the second half.

The 1983 PIK program and drought were successful in reducing the massive stocks that had accumulated for many commodities. Corn stocks are expected to dip to as low as one-half billion bushels by the end of the 1983/84 marketing year. Most of the anticipated reduction from last year's record large 3.1 billion bushel carryover will come from farmer-owned reserves and CCC inventories. The domestic carryover for all feed grains is expected to be less than one-fourth the level of the previous carryover. Food grain carryover stocks are expected to decline only moderately from 1982/83, with an increased feed use of wheat and a sharp reduction in rice production accounting for the drop. The cotton carryover will be cut to about half the year-earlier level. The tightest inventory situation will be in soybeans. Ending stocks are expected to decline to about 140 million bushels, the lowest level in several years.

Participation incentives for the Government acreage-control programs have been scaled back significantly from those of 1983. The 1984 cotton and feed grain programs have no PIK provisions, no paid diversions, and no advance deficiency payments; and there will be no loan premiums nor immediate entry into the farmer-owned grain reserve. The wheat program involves much of the same, except that it does provide for a PIK option. Major program provisions require that planted

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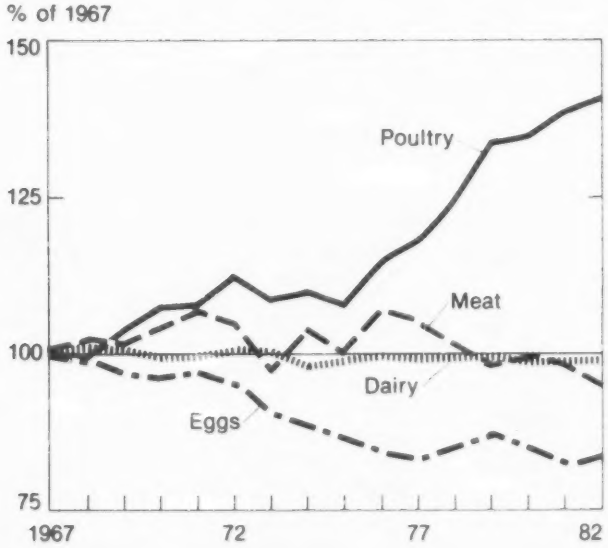
acres be reduced 10 percent from base acreage for feed grains and long staple cotton, 25 percent for upland cotton, and 30 percent for wheat. Once again, there are conservation provisions concerning idled acres. The programs are expected to be unattractive to producers generally, although the feed grain program may be an attractive "insurance policy" for producers experiencing financial stress.

The dollar value of agricultural exports is expected to rise moderately in 1984, while physical export volumes will likely decline once again. The rebound in the U.S. economy should help stimulate economic growth in some other countries, but many nations that buy agricultural products from the U.S. continue to be plagued by huge debt-servicing requirements and weakened currencies. These problems are not likely to be resolved sufficiently in 1984 to be of benefit to U.S. producers.

Meat, Dairy, Poultry, and Eggs

Total U.S. red meat and poultry production is expected to decline slightly in 1984, particularly during the second half. Meanwhile, continued economic growth and improved employment opportunities in the U.S. should help stimulate demand. These opposing trends—a contracting supply against an expanding demand—suggest that livestock prices will improve by midyear. Producers may realize generally profitable net margins during the second half of 1984, based on expectations that feed costs will trend lower as the year progresses.

Per Capita Consumption of Selected Animal Products



Cattle

General economic conditions were on the upswing throughout 1983, although the second quarter proved to be the strongest and only bright spot for the cattle industry. Cattle feeders experienced positive margins during the spring as fed cattle prices rose to their highest level in several months and finishing costs fell to season lows. Demand for stockers was also high, having partially developed from the abundance of PIK wheat grazeout acreage. Prior to this period and since midyear, however, economic conditions of the cattle industry as a whole have been depressed. Had production costs—with the exception of feed grain prices—and interest rates not maintained some degree of stability, a further deterioration in conditions would have occurred.

Inventories of all cattle and calves in 1983 continued a slow decline for the second consecutive year. This pattern should extend into 1984 with projected cow and calf numbers, as well as the number of heifers being saved for herd replacements, continuing to decline. Compared to 1982, calf numbers in 1983 were down 1 percent, the cow inventory declined 3 percent, and the number of replacement heifers was down 4 percent. Total cattle numbers at the beginning of 1984 are expected to be unchanged to down slightly from the 115.2 million on hand in January 1983. The effect of this declining trend in numbers should contribute to an improvement in the economic conditions of the cattle industry during the latter part of 1984.

Weather conditions during the past year played a major role in all areas of agriculture, including livestock production. Side effects from 1983's weather will be apparent throughout much of 1984. A cold and wet winter contributed to slower weight gains and death losses for feeders; however, when the rains stopped, a drought unequalled since the 1930s affected much of the country. A large reduction in feed grain acreage, combined with the extreme heat and lack of moisture in the major feed-producing states, focused attention on declining supplies and prospects of a significant curtailment in yields, thus forcing the already rising feed prices higher. Drought-stressed pastures and high feed prices compelled producers to reduce herd size, sending greater-than-normal numbers of cattle to market and increasing nonfed cattle slaughter. This sudden turn in events also forced hog, dairy, and poultry producers to liquidate inventories sooner than normal and in the process has added to the already large meat supplies.

Unfavorable feeding margins point to more-than-adequate meat supplies during the first half of

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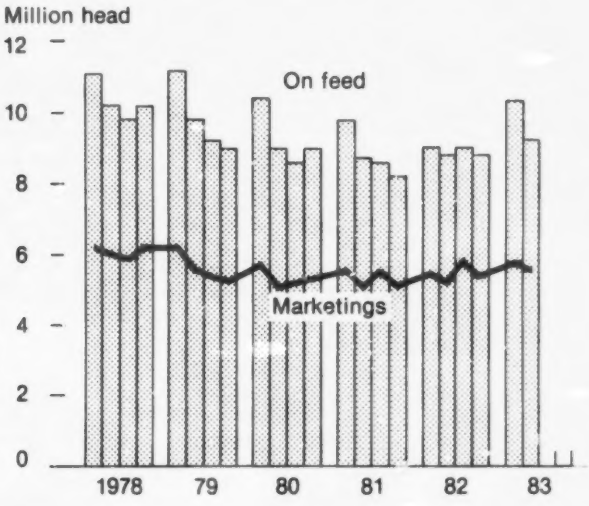
Cattle on Feed and Marketings



Quarterly data for 13 States.

1984, and this means that choice fed-steer and feeder steer prices are likely to hold in the low to mid-$60 range into the second quarter. Static cattle numbers, possible cutbacks in pork production, and projections of a large grain harvest should combine to help strengthen choice steer prices to a high of near $70 per cwt during the second and third quarters and average in the mid $60s over the full year. Feeder steers should average $2 to $3 higher than fed cattle prices. Overall, average cattle prices for 1984 should be moderately above average 1983 prices, but should set the stage for improvements in 1985. This price outlook is partly based on a return to more normal forage conditions and moderate culling of dairy animals.

Cow-calf and yearling operators may find it profitable to carry calves or light yearlings through the winter if feed and financial resources are available. Feeder cattle will be abundant at the beginning of the year, but with the high cost of feeding, they will be priced at a discount, with little chance of prices rising independently of fed cattle. The near-term price outlook does not appear overly promising; therefore, wintering cattle for sale in the second quarter of 1984 and taking advantage of expected price increases may be a viable option. Should producers elect to retain cattle and increase herd size, meat supplies could drop off faster than expected, forcing prices higher earlier in the year.

If, as expected, unemployment levels continue to decline and conditions in the economy generally improve, the demand outlook for beef should gradually strengthen. Recovery has been slow to develop for the cattle industry. It also began slowly for the economy as a whole, but it is now moving at a sustainable level, which over the long run is more beneficial to the cattle industry. Other meats will continue to provide competition for the cattle industry, and because it is not likely that effective red-meat and poultry demand will rise to the extent it did from the 1960s through the mid-1970s, care will have to be given to the future direction of the cattle industry by its producers.

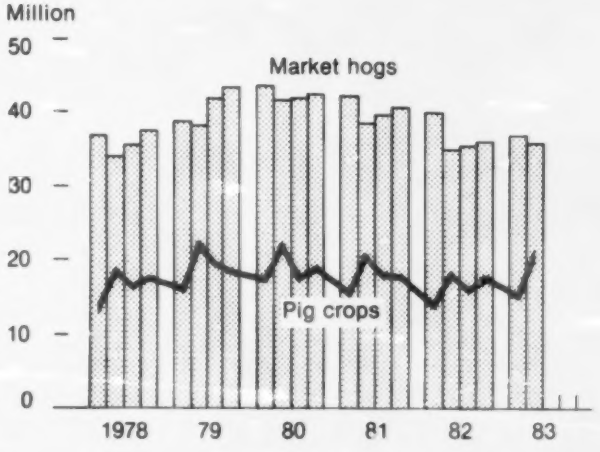
Hogs

Economic conditions within the hog industry deteriorated significantly in 1983, following excellent profits in 1982. Substantially lower hog prices, combined with higher feed costs, resulted in negative feeding margins during almost every month of 1983.

Market trends underway during the last quarter of 1983 appeared to indicate the bottoming of the 3½-year hog cycle. Based upon this assumption, a period of consolidation followed by increasing hog prices is expected in 1984 as the industry responds to major changes in grain and protein prices. A 1- to 4-percent reduction in farrowings is anticipated in the first half of 1984, with continued positive adjustments expected to occur in the latter half of the year.

As of September 1, 1983, the hog breeding inventory was estimated at 5.83 million head, up 5 percent from a year earlier, but down 8 percent when compared to September 1, 1981. Total market hog inventory, at 40.1 million head, had increased 11 percent from a year earlier.

Market Hogs and Pig Crops



Pig crops—December-February, March-May, June-August, and September-November. Market hogs on farms—December 1 previous year, March 1, June 1, September 1, and December 1. Quarterly data for 10 States.

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Projections support an estimated slaughter increase of 7 to 9 percent in the first quarter of 1984 and moderating to a 2- to 4-percent increase in the second quarter. Slaughter at these levels should lead to prices averaging in the low to mid-$40s per cwt in the first quarter and $45 to $50 per cwt during the second quarter of 1984 at the seven major markets.

Total pork production in the last half of 1984 will depend upon hog producers' response to several important variables—most notably, the acreages and growing conditions of corn and soybeans. Adverse weather would result in a major breeding-herd liquidation due to excessively high grain and protein costs, while normal crop conditions should result in a small expansion of the breeding herd. An expansion of the breeding herd would mean retaining gilts to increase the fall and winter pig crops. This would lower slaughter in the second and third quarters and would result in higher prices for market hogs.

During 1983, consumer demand for pork remained relatively strong, despite record high farm-to-retail price spreads and high unemployment. Consumer demand for pork in 1984 is expected to show improvement as the national economy improves and retailers reduce their record price margins on pork. Competition from supplies of other meats may minimize the increases in pork consumption. Although broiler and beef supplies are expected to show only modest changes, total meat supplies may increase significantly enough to affect prices due to dairy-herd liquidation. Lenders serving hog producers should watch this development closely because of its potential impact on hog prices.

Hog prices in the last half of 1984 will be especially sensitive to changes in the variables just noted, but the combination of lower hog production and an improving national economy suggests a second half price average of $50 to $55 per cwt.

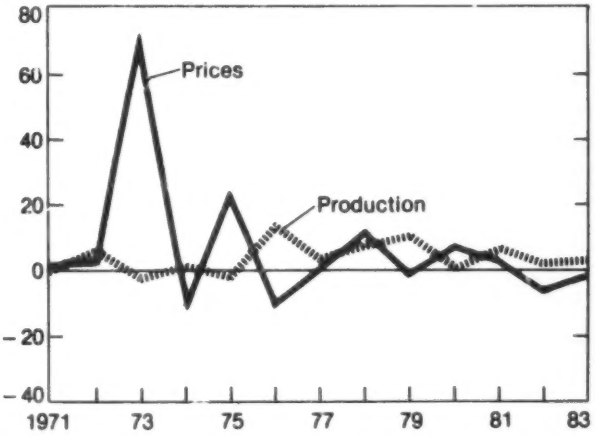
Broilers

Broiler production increased at an average growth rate of 5.5 percent during the first half of 1983. This strong increase in supply, coupled with weak export markets—the result of a strong U.S. dollar, reduced oil revenues in the Middle East, and continued subsidization of international broiler production—culminated in a decline in net margins for the first half of 1983, continuing the prolonged trend of consecutive quarterly losses measured at the wholesale level.

The USDA recently revised its broiler budgets from a 9-city weighted average to a 12-city weighted average price. The new method counts brand-name

Broilers: Changes in Production and Farm Prices

% change from year earlier

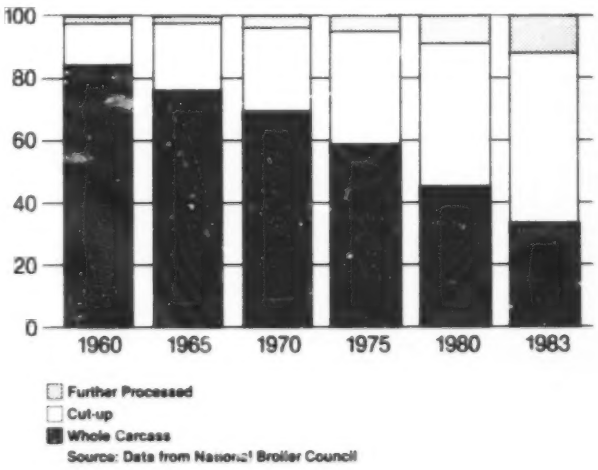


1982 preliminary, 1983 forecast. December 1 previous year through November 30 current year.

birds and has resulted in prices averaging 2 to 3 cents a pound higher. However, caution should be exercised in interpreting broiler net returns using USDA budgets. For much of the industry, returns should be measured at the retail, not the wholesale, level. Additionally, USDA broiler budgets measure the price of whole birds at selected markets. Currently, slightly over one-third of the broilers sold are marketed as whole birds, while the remainder is sold as cut-up or further processed and is sold at a higher price. Moreover, costs will vary greatly across producers. Therefore, net-margin numbers should be used as an indication of the direction of profitability and not as an absolute return to the industry.

Composition of Broiler Sales

Percent of Total Sales



Source: Data from National Broiler Council

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Second-half 1983 broiler production was flat due to heat losses and a gradual retrenchment in pullet-chick replacements. Conditions in the broiler sector were weak as 1983 drew to a close and prospects for early 1984 were little better, principally the result of higher feed prices associated with the 1983 drought-stricken corn and soybean harvests. The combination of record-level supplies of red meat and slow growth in real consumer incomes has heightened competition for consumer meat outlays, weakening any underlying potential price strength in the broiler industry in the near term. Per capita consumption of poultry may be adversely affected, temporarily canceling the established trend toward increased poultry consumption that reflects a competitively priced alternative to red meats, as well as changing consumer tastes and preferences for leaner, lower-fat meats. Consequently, positive net margins will elude broiler producers for the first part of 1984.

Broiler producers may be poised for renewed profitability in the latter part of 1984, if their abilities for quick production responsiveness have not been weakened by the cutback in replacement chicks for the hatchery supply flock that was prompted by the relentless cost-price squeeze over the last several years.

Turkeys

Following a normal (see-saw/cyclical) pattern, positive net margins in the latter half of 1982 prompted turkey producers to expand output 11½ percent in the first half of 1983 from a comparable period of a year earlier. Weak export markets, coupled with a strong supply response, resulted in negative margins at the wholesale level for the first three quarters of the year. By the fall, turkey production had slowed due to the hot summer, which kept slaughter weights down, higher feed costs, and a decline in the number of eggs in turkey incubators. Fourth-quarter supply—the seasonal peak for turkey producers—including production and built-up stocks, was expected to be down approximately 1 percent from 1982. Still, turkey prices were not expected to exhibit strong upward price pressure, principally the result of record red meat supplies. The price of New York 8- to 16-pound young hen turkeys is expected to follow a normal seasonal pattern, averaging several cents a pound above year-earlier levels. An upward trend in per-capita consumption of turkey is projected for 1984, given its competitive price position, as well as the increased marketing of processed turkey products.

Eggs

Continued weak export markets and growing production costs have induced producers to implement changes in production methods. Given the costs of purchasing replacement pullets and the uncertainty of future markets as compared to increasing the average age of the flock, producers are force-molting their birds, opting for greater productivity per bird instead of relying on rapid culling techniques. Evidence of this is reflected in fourth-quarter egg production (the normal seasonal peak), which is expected to be off 1 to 3 percent from last year, despite a 13-percent reduction in the number of replacement pullets entering the laying flock from a year earlier. Still, price gains in 1984 will be constrained in light of the plentiful supplies of other high-protein foods.

Dairy Outlook

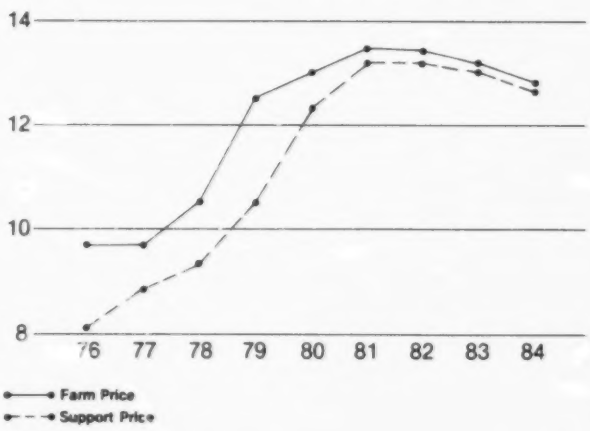
The outlook for the dairy industry is one of uncertainty and concern. High levels of U.S. milk production spurred by an artificially supported milk price is the root of the problem. As a result of excessive Government expenditures (in excess of $2 billion in 1982 for the dairy program), legislators have been under pressure to construct a new dairy program. Effective on September 1, the USDA implemented a second 50-cents-per-cwt assessment on all milk sold commercially.

In early October, the U.S. Senate passed the dairy compromise bill, containing a provision that would allow dairy farmers to receive $10 per hundredweight on 5 to 30 percent of their base milk production that is diverted. This bill was passed by the House on November 18 just before Congress adjourned for the session, and it was signed into law on November 29.

Several provisions of the new law went into effect on December 1: the $1-per-cwt assessment ceased,

Farm and Support Prices of Milk

Dollars per CWT



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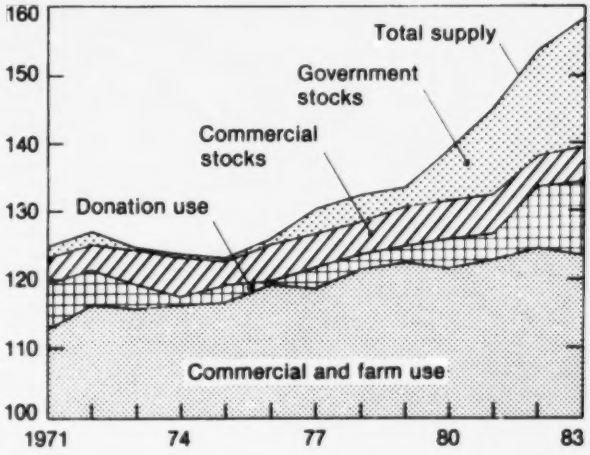
the support price dropped from $13.10 to $12.60, a new 50-cents-per-cwt assessment began, and a $0.15 national advertising checkoff (less any state advertising already taken) is to be put into effect. The support price will hold at $12.60 until at least April 1, 1985. At that time, the support could be cut another 50 cents, if it appears that Government purchases of surplus dairy products will exceed the equivalent of 6 billion pounds of milk in the following 12 months. A third 50-cent cut in the support price could take place on July 1, 1985, if Government purchases are expected to exceed 5 billion pounds of milk equivalent in the following 12 months. Thus, the support price could drop to $11.60 during the final quarter of the act; but if adequate consumer supplies were threatened, the latter cut would not be made, and the support could be increased. The 50-cent assessment to help fund the paid diversion program is to end on March 31, 1985.

The voluntary diversion program will last for 15 months, effective January 1, 1984, until March 31, 1985. The Secretary of Agriculture is to offer the program by January 1 and dairy producers are to have until February 1, 1984 to enter a contract. The payment will amount to $10 for each hundred pounds by which the producer holds production below his or her base level. A producer's history is to be either calendar 1982, counting the first quarter twice or the average of calendar 1981 and 1982, again taking the first quarters twice.

Participating farmers' cows and facilities can not be sold, leased, or transferred to others who would use them for milk production. Such animals can be sold for slaughter, but the bill includes several safeguards to soften the impact that the extra meat supply will have on prices for beef cattle, pork, and poultry. Producers enrolling in the program are required to file a plan estimating how much of their milk cutback is to achieved by selling off cows. The Secretary of Agriculture can vary (within specified limits) the depth of producers' milk cutbacks on a quarterly basis, if this is needed to avoid a concentration of cull cow marketings in a short period.

Milk Supply, Use and Stocks

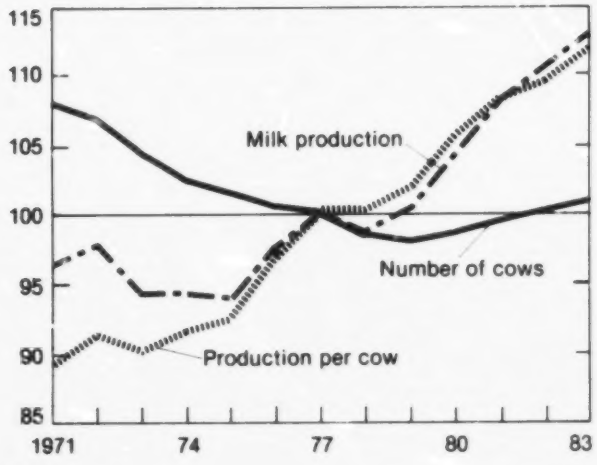
Billion pounds



1983 forecast. Stocks as of December 31.

Milk Production, Number of Cows, and Milk per Cow

% of 1977



1983 forecast.

The situation for dairy farmers who choose not to participate in the program, will, initially at least, remain the same as with the $1-per-cwt assessment originally in effect. With this situation and assuming a 5-percent inflation rate, dairy farmers will likely experience a 13-percent reduction in net farm income in 1984 from 1982. Such a decline in income, combined with continued uncertainty for the future, suggests that such dairy operators will not be purchasing land, buildings, or equipment, unless absolutely needed. In the highly concentrated dairy areas of the country, we could see a continuation in the erosion of asset values of dairy farms.

The Grain, Oilseed, and Fiber Complex

The PIK program and the drought served to substantially reduce massive surpluses that existed for many commodities at the beginning of 1983. Carryover stocks for feed grains are expected to be reduced to less than one-fourth of the year-earlier level by the end of the 1983/84 marketing

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year. Food grain carryover stocks will remain large, but are expected to register a moderate decline from 1982/83. Carryover stocks for cotton and soybeans will be significantly lower.

Prices for corn and soybeans, in particular, continue to be very favorable for cash-grain producers and will likely stimulate a strong acreage response this spring. Government programs announced for 1984 may not be stringent enough to effectively control the anticipated supply response. There appears to be a very real danger that increased production could re-create a surplus situation, though of less serious proportions than the one in existence a year ago.

1984 Government Farm Programs

Massive farmer sign-up in the 1983 Government programs, a drought, plus criticism of the administration's largesse to farmers have sharply reduced the incentives for participating in the 1984 Government programs. In fact, they are noteworthy mostly for what they do not provide, compared to the 1983 programs. For the 1984 cotton and feed grain programs, this means no PIK, no paid diversion, and no advance deficiency payment. The wheat program is much the same as these programs, except that it does provide for a PIK option. In contrast with prior programs other than PIK, there will be liquidation charges for those who are signed up at the cutoff date, but then fail to comply.

These programs are expected to be relatively unattractive to producers. As a result, a major expansion in corn plantings for 1984 is expected, and little relief will be provided to the wheat oversupply situation.

More specifically, under each of the announced programs, the sign-up period is January 16 through February 24, significantly shorter than last year. A producer's program base will be the average of land planted or considered planted in 1982 and 1983. The "considered planted" terminology is used so that land idled under programs in those years is eligible. The major program provisions require that plantings be voluntarily reduced by 10 percent from base acreage for feed grains and long staple cotton, 25 percent for upland cotton, and 30 percent for wheat. The corresponding acres for conservation use must equal 11.1, 33.3, and 42.9 percent of plantings.

Also, there is no cross compliance or offsetting compliance required. As was the case last year, there will be one base for corn-sorghum and another for barley-oats. As noted previously, there is a PIK option for the 1984 wheat program. Farmers, by diverting an additional 10 to 20 percent of their base acres, will receive a payment-in-kind equal to 75 percent of the established yield. The PIK-option participants will not receive wheat from CCC stocks. They must first use their outstanding reserve or regular CCC loans for PIK. Those participants not having outstanding loans must agree to harvest for PIK.

Table 17
Program Prices for 1983 and 1984 Crops*

		Loan Rate		Target Price	
Commodity	**Unit**	**1983**	**1984**	**1983**	**1984**
Corn	$/bu	2.65	2.55	2.86	3.03
Sorghum	$/bu	2.52	2.42	2.72	2.88
Barley	$/bu	2.16	2.08	2.60	2.60
Oats	$/bu	1.36	1.31	1.60	1.60
Wheat	$/bu	3.65	3.30	4.30	4.45
Rice	$/cwt	8.14	8.00	11.40	11.90
Cotton	$/lb	.55	.55	.76	.81

*Target prices are the minimums established by the 1981 farm act. Congress may change the law to allow a lower target. Rice program details were not announced as of this writing— the loan and target prices shown are the lowest allowed by the 1981 legislation.

Corn

Corn prices have experienced considerable strength from a year ago because of the impact of the PIK program and the drought conditions experienced during the 1983 growing season. These two factors reduced the size of our corn crop from an 8.39-billion bushel record in 1982 to a 4.12-billion bushel crop in 1983. The small harvest, coupled with our record carryover stocks of 3.14 billion, meant a total supply of 7.26 billion bushels at the outset of 1983/84. This is considerably below the previous year's supply of 10.68 billion bushels. Thus the objective of reducing our corn supply to a more manageable level was accomplished in one season.

Domestic corn usage is projected to be around 4.9 billion bushels, which would be down from the 1982/83 usage of 5.67 billion. The reasons for this reduction include a gradual hog liquidation process that started in the summer of 1983, reduction in the number of cattle on feed, and substituting wheat and other feed grains for corn in feeding rations. All these, in turn, are due to the relatively high price of corn.

Exports of corn are expected to be 1.87 billion, which would be very close to 1982/83 exports. Imports by the USSR are expected to decline slightly from last year, due to their bumper feed grain harvest, but stronger import demand is likely from the EC because of their poor harvest. Expectations

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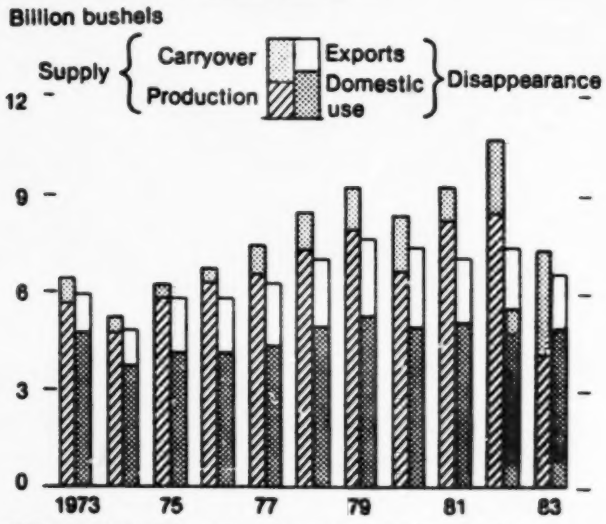
Corn Supply and Disappearance



1982 estimated, 1983 projected. Supply includes imports. Year beginning October 1.

are for exports to Japan to increase as their economy recovers. Exportable feed grain supplies among major foreign exporters will be limited at least until Southern Hemisphere crops become available in March/April 1984. Total U.S. corn export demand for the year will depend upon the strength of our dollar, the availability of credit to some importers, crop prospects among our competitors, and the competitiveness of wheat.

With domestic use projected at 4.9 billion bushels and exports at 1.87 billion, it is likely we will experience a total use of 6.76 billion bushels for 1983/84, thus leaving an ending stock inventory of only 510 million bushels, which would be our lowest ending inventory since 1975/76. This situation supports the stronger corn market that has occurred, and expectations are for the corn market to maintain strength through the first two quarters of 1984 with the 1983/84 marketing year experiencing a $3.25 to $3.55 per bushel average.

In looking to the 1984 corn crop, there will not be a PIK program, but instead a voluntary set-aside program and a reduction in the loan rate. At this time, expectations are for nominal participation in the program, especially if prices remain strong through signup and into planting times. Although there may be some substitution of soybeans for corn and operating expenses could be up around 5 percent, these factors will not limit all-out production in 1984. It appears we could experience another 8-plus billion bushel corn crop if growing conditions are supportive. The projection of another 8 billion bushel corn crop would create pressure on the market, thus causing a market decline the last two quarters of 1984, but not to the level we experienced in 1982.

Other Feed Grains

The price outlook for grain sorghum, barley, and oats will closely reflect their feed value relationship with corn. Sorghum acreage in 1983 was down 30 percent, similar to corn, but yields were less affected by the drought and the crop was 43 percent smaller than in 1982. Barley and oat yields were impacted much less than sorghum, and lacking a PIK program, acreages of these two crops were not as drastically altered from 1982 as was the case with corn and sorghum. The barley acreage and harvest were actually larger than in the prior 2 years.

In contrast with the beginning corn supply being down one-third from 1982/83, the combined supply for the other three feed grains was off only about 10 percent at the outset of 1983/84. This relatively ample availability of the other feed grains, combined with the large wheat supply, is significantly moderating the tight corn situation. While domestic feed use of corn is expected to drop 18 percent from 1982/83, the overall decline in feed use of feed grains is projected at 13 percent. Also, noteworthy has been the unusually strong export demand for barley; shipments in 1983/84 could turn out to be the second highest on record.

Wheat

Although U.S. wheat production increased at a 15-percent average pace between 1978 and 1982, the estimate for 1983 reflects a 14-percent decline. This can be attributed to the 1983 PIK program, which decreased harvested acres 22.6 percent from 1982. However, yields per acre increased nearly 12 percent to a record 39.5 bushels, negating some of the effect of the reduced acreage.

In spite of the 400 million-bushel lower harvest, the domestic supply of wheat is estimated to be only 26 million bushels below the record supplies of 1982/83. Domestic usage is expected to increase 152 million bushels or 16 percent over 1982/83, primarily reflecting increased feed usage. Exports are expected to decline 110 million bushels or 7 percent; this is in the wake of a 15-percent decrease in exports from the previous year. Efforts to regain prior export levels are complicated by continued increases in wheat production outside the U.S., subsidized competition from the EC, unfavorable political developments in certain countries, and a comparatively strong U.S. dollar. Although new long-term grain agreements have been consummated with the USSR and the People's Republic of China, neither is expected to impact heavily on total usage.

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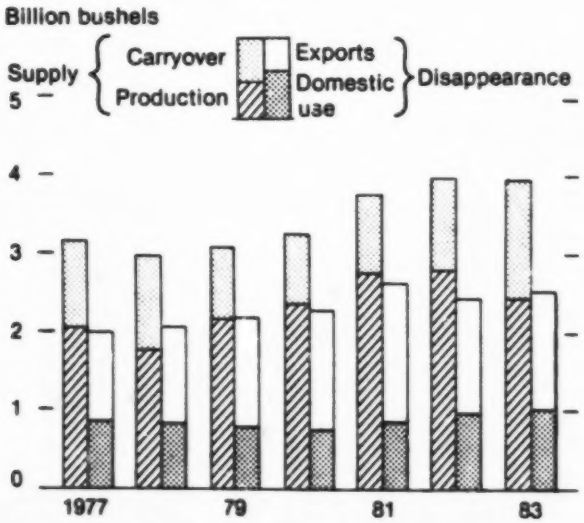
World wheat production for the 1983/84 marketing year is anticipated to slightly surpass the record 480 million metric tons of 1982/83 and for the third year in a row will outpace use. Total world supply is expected to reach 580 mmt, and stocks will again edge up. Therefore, the void created by the U.S. PIK and acreage-reduction programs will have been filled by world competition.

China and India are expected to have record harvests in 1983/84 with increases of 17 and 15 percent, respectively, over the previous year. The size of the USSR crop remains similar to that of 1982/83, in spite of reduced plantings. Favorable spring wheat yields will reduce its import needs for higher quality wheat. Improved moisture conditions in Australia may result in yields double those of drought-stricken 1982/83. Canada will remain a strong export competitor with a 9-percent production increase expected on the heels of 3 consecutive years of increased production. Argentina is expected to come within three million tons of equaling its 1982 record harvest, but its stock position will remain strong. Adverse weather in the European community will result in a large quantity of lower quality wheat.

U.S. ending stocks are expected to remain near the 1.5-billion bushel level, still accounting for some 40 percent of world ending stocks. Of those domestic carryover stocks, 40 percent is expected to be held in the farmer-owned reserve, 13 percent by the CCC, and the remaining 690 million bushels are estimated to make up free stocks. This would represent a 130-percent increase in free stocks over the 1982/83 marketing year.

Wheat Supply and Disappearance



1982 preliminary, 1983 projected. Supply includes imports. Year beginning June 1.

Prices during 1983/84 are expected to average near the 1983 CCC loan level of $3.65—much as they did during 1982/83. With fewer benefits for program participation in 1984, the CCC loan rate, which will drop to $3.30, may become a weaker floor for the price of wheat during the 1984/85 marketing year. In spite of this factor, U.S. wheat prices are anticipated to hold their own well into 1984 due primarily to the strength in corn prices.

Rice

The rice outlook is characterized by a tremendous decrease in domestic supplies, a modest increase in usage, and a continued increase in foreign rice production. Although prices for rice have strengthened, continued strength depends on the improvement in U.S. and world economies.

The 1983 rice program, in combination with delayed plantings, reduced the 1983 U.S. rice crop one-third from last year and will push U.S. rice supplies to their lowest level in 3 years. This decrease in production is primarily due to record-high participation in the 1983 rice program, which included acreage reduction, paid land diversion, and the payment-in-kind (PIK) program. Total U.S. rice supplies are forecast at 175 million cwt, with beginning stocks accounting for well over one-third.

Usage of U.S. rice in 1983/84 is expected to increase slightly above the 1982/83 season's level of 132 million cwt. Export levels are expected to remain about the same, while a modest increase is expected in food, seed, and brewers' use. Total usage of rice is forecast to exceed production in the 1983/84 season by 36 percent. This should lower ending stocks about half from the record 71 million cwt at the end of July 1983 to about 34 million cwt. Accordingly, prices are expected to strengthen with season average prices ranging from $8.50 to $10 per cwt, compared to the 1982/83 season average price near the loan rate of $8.14 per cwt. Even with this price increase, the forecasts remain below the target price of $11.40 per cwt, making deficiency payments likely in 1983/84.

The assumptions underlying this price outlook may not develop. First, the increase in rice usage is based on improving U.S. and world economies. The export demand presumes a 5.5-percent growth rate in the key U.S. export markets, many of which are developing nations. Additionally, sales to the Middle East and the European community dropped by 50 percent due to a change in import policies, and Thailand has increased export efforts aimed at such U.S. markets as Indonesia. Thus, while the U.S. crop has been reduced by one-third, there is no guarantee that prices will respond accordingly.

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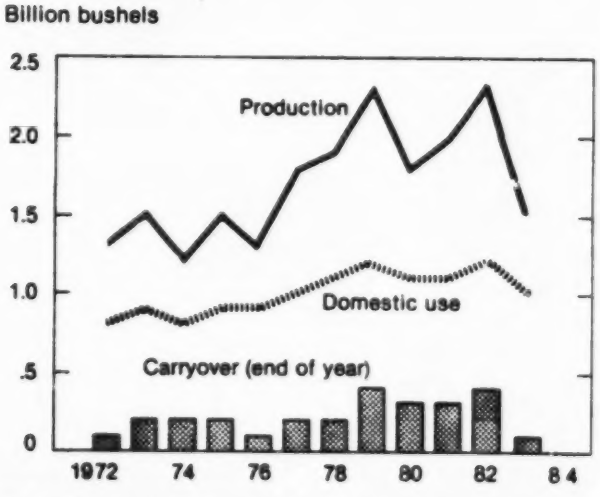
Soybeans

A 12-percent decline in soybean acreage planted in 1983 plus the severe drought reduced production to 1.54 billion bushels. Total usage is projected at 1.78 billion bushels for the 1983/84 marketing year, and this would reduce carryover stocks to 140 million bushels on September 1, 1984. Carryover will only be 8 percent of current needs, or a 30-day supply. This is near what are considered pipeline requirements.

The limited soybean supply means a strong potential for volatility in soybean prices. Major factors impacting usage and price are the size of the current South American crop and the exchange rates of the U.S. dollar. The South American crop is expected to be larger because of increased plantings, and it will be available the last half of the U.S. marketing year. Current exchange rates discourage U.S. exports of soybeans with a strong dollar making U.S. soybeans more expensive in foreign ports. A worldwide shortage of vegetable oil should keep upward pressure on soybean prices.

New crop futures prices have been encouraging the planting of corn versus soybeans. Corn prices will have to diminish or bean prices increase for farmers to be encouraged to plant more soybean acres in 1984. Adverse conditions impacting the current South American soybean crop could cause significant price escalation for soybeans. The U.S. season average farm price is projected from $7.75 to $9.00 per bushel for this marketing year.

U.S. Soybean Production, Use, and Carryover



Domestic use includes crushings, seed, feed, and residual. Year beginning September 1.

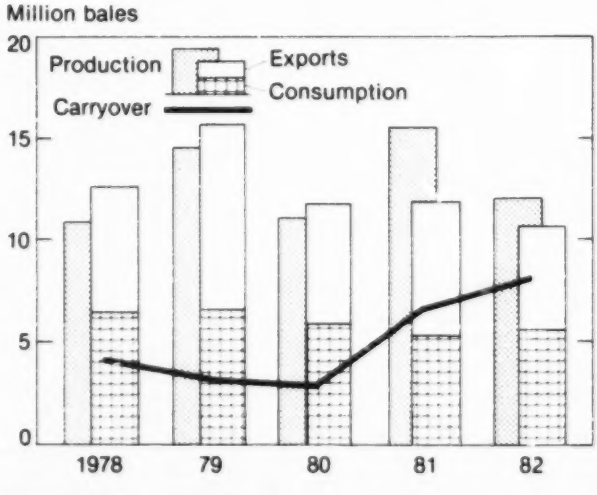
Cotton

The outlook for cotton is one of short-run optimism for prices, followed by a gradual improvement in demand as the economic recovery continues. For the U.S., the decreased levels of production, improvement in stock levels, and increased mill usage all point toward improved prices in the 1983/84 marketing year. However, most analysts feel that cotton's highest prices will be reached early in the season. The outlook for U.S. cotton in 1984 is for a tremendous increase in production, a modest increase in domestic usage, and exports likely to remain the same. Thus, cotton prices later in 1984 are expected to trend downward.

U.S. cotton production for 1983/84 is estimated at 7.5 million bales, providing price support in the 76 to 78 cents-per-pound range. Cotton quality is expected to vary greatly. Short-staple cotton is expected to be abundant relative to the supply of longer staple cotton, causing a greater-than-usual price differential. The cotton supply/demand estimates show 1983/84 carryover down to a 135-day supply versus the 269-day supply at the beginning of the marketing year. Although U.S. production is down 37 percent, world production is only 3 percent smaller. Therefore, prices are not expected to be pushed higher in 1984.

There are some bright spots on the demand side. Domestic mill demand is expected to increase, and exports are expected to improve slightly. The cotton industry is optimistic that an improved demand for textiles will accompany a projected general

U.S. Cotton Production, Use, and Carryover



1982 preliminary. Year beginning August 1. 480-pound net weight bales. Ending carryover.

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economic recovery. Additionally, many stocks have been reduced to near minimum. However, U.S. market share is not expected to grow significantly due to increased foreign production and the current strength of the dollar.

Other Crops and Specialties

Tobacco

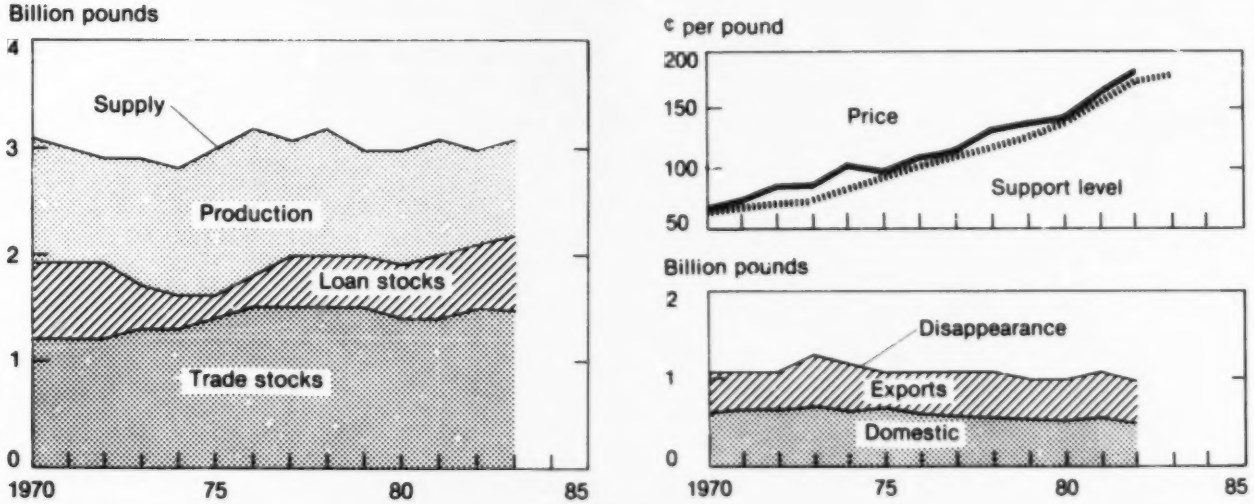
Hot, dry weather conditions, coupled with smaller quotas, significantly reduced the harvests of flue-cured and burley tobacco crops in 1983. Prices are not likely to be under much pressure, despite the reduced new-crop output, because carryover stocks were large and the demand for U.S. tobacco is expected to remain soft. The worldwide recession and changes in Government policies have created an uncertain outlook for the U.S. tobacco industry.

U.S. tobacco production totaled 1.38 billion pounds in 1983, down 30 percent from the previous year. A 10-percent quota reduction and poor growing conditions accounted for reduced yields and quality. Flue-cured output is expected to fall to its lowest level in 40 years. The crop is estimated at 837 million pounds, down 16 percent from the previous year. However, because of large carryovers from previous years, total supplies of all U.S. tobacco for 1983/84 may fall only 4 percent. Ending stocks going into the new marketing year were estimated at 3.82 billion pounds, up 7 percent from a year earlier. These crop carryovers mean that a sizable oversupply of U.S. tobacco remains even after the sharp production drop.

Flue-cured tobacco placed under loan reached a record high in 1982. The Flue-Cured Tobacco Cooperative Stabilization Corporation received 26 percent of total producer sales in 1982 and is expected to receive approximately 20 percent of 1983 marketings. The 1982 No-Net-Cost Tobacco Program established a system whereby growers, to become eligible for price supports, were assessed marketing fees to offset program costs. In reaction to the unprecedented level of Co-op purchases in 1982, assessments were raised from three cents per pound to seven cents in 1983. This assessment applies to tobacco leased and transferred, as well as tobacco marketed by growers. Allotment owners may pass their assessment costs to the grower in the form of higher lease rates.

Exports of U.S. tobacco are expected to fall below last year's level of 526 million pounds. Tobacco buyers and industry spokesmen cite several reasons for the declining demand for U.S. tobacco output. The worldwide recession has caused a shift in consumer purchasing patterns. Because of their reduced buying power, consumers now appear to be smoking lower-priced tobacco products. These products are manufactured with lower-quality and less-expensive tobaccos. Due to its higher quality and price, U.S. leaf does not meet the market demand in this area. Also, the recession has caused state and national governments to increase excise taxes on tobacco products to enhance general tax revenues. This has dampened demand for expensive U.S. tobacco products. The strong U.S. dollar has also discouraged export sales of tobacco.

Flue-Cured Tobacco: Supply, Price, Use



1982 preliminary, 1983 forecast. Trade stocks include manufacturers' and dealers'. Crop year beginning July 1.

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Legislation that makes extensive changes in the tobacco price-support and production-control program passed Congress on November 18, just prior to adjournment, and was signed into law on November 29. The bill contains provisions that freeze 1984 tobacco support prices at the 1982 and 1983 levels and abolish the lease and transfer system beginning in 1987. Under the act, nongrower allotment holders are required to sell their allotments, farm the allotments themselves, or lease their allotments to someone who will grow tobacco on the allotment owner's farm. Quota lease costs are the single highest expense item paid by the grower. If the ownership of allotments is shifted to the producer, this cost would be eliminated. It is anticipated that support prices could be lowered as a result, and that U.S. tobacco would become more competitive on world markets.

Fresh Vegetables

Like many crops, weather played a major role in the production of vegetables during 1983. After strong production during January-February, a wet, cool spring prevented acreage from being planted to some crops, while reducing the yields of others. These conditions held production of the major fresh vegetables slightly below 1982 levels. Broccoli and onion output posted substantial declines, while the sweet corn and carrot harvests gained the most. Production of the two largest items, lettuce and tomatoes, rose slightly.

Demand trends for fresh vegetables have played an important role for the industry. Since the early 1970s, per-capita consumption of fresh vegetables has increased steadily, reaching a 30-year high in 1982. This year's combination of lower supplies and strong demand strengthened prices during the second and third quarters. As a result, the 1983 index of prices received by growers for fresh vegetables averaged 125 to 130, compared to 125 in 1982.

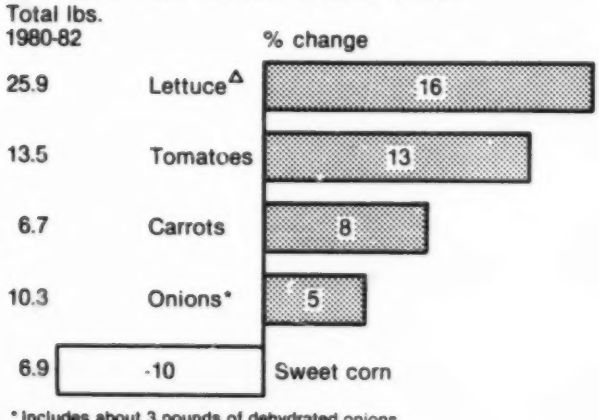
Processed Vegetables

The 1983 drop in production of processed vegetables was much more dramatic than the decline in fresh-vegetables output. For frozen vegetables, the pack fell 14 percent. Nevertheless, due to a record carry-in, the supply declined less than 2 percent and is still substantially above historical levels of consumption. Given the adequacy of current supplies, declines in contracted areas of frozen vegetables are likely during 1984, particularly for sweet corn. The pack of canned vegetables was off 6 percent. With the carry-in up 17 percent, the resulting supply was down only 3 percent.

In contrast to the trends for fresh vegetables, changes in the per-capita consumption of processed vegetables have been less than favorable. While per-capita consumption for frozen vegetables has remained constant, canned vegetables have lost steadily over the last decade. Between 1972 and 1982, canned consumption has dropped 13 percent.

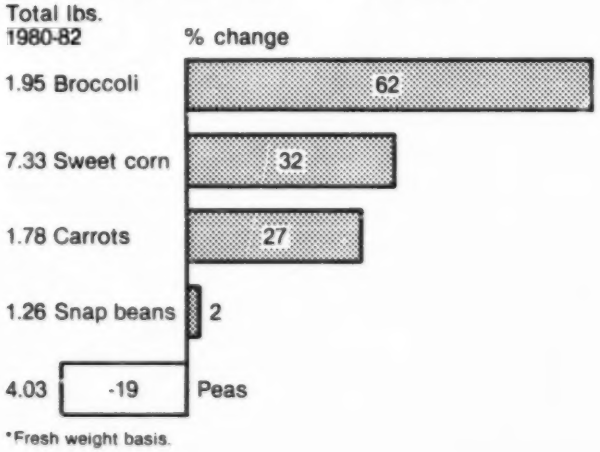
The long-term outlook for the vegetable industry hinges on these demand trends. The per-capita consumption decline for canned vegetables has actually been strong enough to decrease total consumption of processed vegetables. Under these conditions, it will be difficult to increase, or even maintain, market prices without a structural decline in production and processing capacity. For fresh vegetables, the opposite is true: strong demand will help maintain grower prices. The key to fresh-vegetable prices will remain the impact of

Changes in Fresh Vegetable Consumption Per Capita Between 1970-72 and 1980-82



*Includes about 3 pounds of dehydrated onions.
△Includes escarol.

Changes in Frozen Vegetable Consumption Per Capita Between 1970-72 and 1980-82*



*Fresh weight basis.

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weather on total supplies and the timing of production

Potatoes

Over a number of years, the market for potatoes has demonstrated an inelastic demand. A relatively small percentage change in production can bring large fluctuations in prices. With a smaller 1983 harvest, grower prices are favorable, and larger potato acreages are expected in 1984.

The potato crop is divided into four seasonal groups: winter, spring, summer, and fall. The fall crop, which typically exceeds 85 percent of total yearly production, is estimated to have dropped 5 percent in 1983 to 293 million cwt. The reduction derived from a combination of fewer acres and weather-related problems. Yields were generally lower in most producing areas except Washington, where increases were recorded. Eastern states' production was down 19 percent based on sharp acreage cuts in Maine and New York, along with wet spring and hot, dry summer growing conditions. Both Central and Western states' production was down 2 percent, with Idaho not realizing full potential this year due to blight, early frost, and generally cool, wet summer conditions.

Table 18
U.S. Fall Potato Acreage and Production, 1978-1983

Item	1978	1979	1980	1981	1982	1983p
Million acres	1.17	1.07	.98	1.05	1.09	1.05
Million cwt	325	297	266	296	308	293

p = preliminary

The smaller fall crop followed reduced spring and summer production, which left marketing channels free of overlapping stocks. The total 1983 production from the four seasonal groups was projected at 330 million cwt, down 6 percent, though some private industry analysts were projecting lower final fall crop figures based on sharper yield reductions.

These conditions are setting the stage for a strong market during the 1983/84 season. Early price indications are running above year-ago figures, with grower prices expected to average $5.25 to $5.75 per cwt for the season.

Fruits and Nuts

Total United States citrus production for 1983/84 is forecast at 14.0 million tons, up 4 percent from 1982/83 and 16 percent above 1981/82. Increases in production are forecast for each of the three major crops: grapefruit, lemons, and oranges. A 12-percent increase is anticipated in lemon production, while the forecasted increase in the grapefruit crop is 7 percent.

Although the 1983/84 orange crop is forecast to increase 2 percent to 223 million boxes, the crop varies significantly among regions. The increase is due entirely to a 20-percent jump in the Florida production to 168 million boxes. The Arizona, California, and Texas crops will be down 16, 37, and 7 percent, respectively. Although smaller, the Arizona and California crop is characterized by much larger sizes. The estimated production, combined with a juice yield of 1.43 gallons per box, indicates a concentrate production of 195 million gallons, below anticipated U.S. consumption of 230 million gallons. Nevertheless, the higher carry-in and ample foreign supplies should keep prices steady during the coming year.

For 1983, noncitrus production was 12.2 million tons, down 13 percent from 1982, but 1 percent above 1981. Increases in apple, nectarine, and plum crops were offset by declines in production of apricots, cherries, grapes, peaches, and pears. Grape production totalled 4.9 million tons, down 25 percent from 1982. Increases in Michigan, New York, Pennsylvania, and Washington were more than offset by a dramatic drop in California.

Production of California wine, table, and raisin grape varieties fell 17, 27, and 26 percent, respectively. These declines will have a particularly beneficial impact on the wine industry. Smaller production and improved wine shipments during the last two quarters of 1983 will alleviate some of the pressure created by the buildup of inventories.

For the second consecutive year, United States apple production increased during 1983. Although still below the record crop of 1980, the 1983 crop was 2 percent above the previous year. With stagnant consumption trends for fresh and processed apples, increased imports, and abundant supplies of other fruit, 1983 apple prices were below 1982 levels for most of the year. There are several early positive signs for 1984. First, apple prices should benefit seasonally from the decline in Arizona and California orange supplies. Secondly, the export outlook for 1983/84 is more favorable than last season because of smaller crops in Western Europe.

United States tree nut production also decreased significantly during 1983: almond production fell 30 percent, while walnut production dropped 23 percent. In spite of this decline, supplies of tree nuts remain adequate due to the large beginning

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stocks position. Although the strong dollar continues to depress export sales, lower foreign production and improving economies in the major importing countries should improve export shipments.

Timber

Stumpage values and log prices represent a classical example of derived demand. These markets depend on the production of lumber and wood products, which, in turn, depend on residential construction activity. The level of housing starts is the single most important indicator in the lumber demand picture. Residential usage has traditionally accounted for over 40 percent of softwood lumber consumption.

Over time, the housing industry has proven to be very interest-rate sensitive. Volatile interest rates have been directly responsible for problems experienced by the housing industry over recent years. Interest rates not only influence domestic housing starts, but also the strength of the dollar on foreign markets and export demand.

Private housing starts for 1983 are expected to be 1.65 to 1.7 million units, after the 1982 low of 1.06 million. The first two quarters of 1983 started strong based on the beginning of economic recovery and lower interest rates. A peak of 1.9 million was reached in August. Higher mortgage rates midyear brought a more cautious attitude on the part of builders and a marked reduction in starts. Fourth-quarter 1983 starts were projected at the equivalent of 1.55 million units annually.

With gradually improving economic conditions expected during much of 1984, slightly increased housing starts are expected. Current forecasts for 1984 range between 1.7 and 1.75 million units for the full year.

Export demand for logs in 1984 is expected to remain stable with 1983 exports of 2.7 billion board feet, which was down from 2.8 in 1982. Lumber exports for 1983 were near 1.7 billion board feet, up 4 percent from 1982; such exports are projected to increase 6 percent during 1984.

The industry feels that timber prices bottomed during 1982 and began a sustainable recovery in 1983, following housing. The recovery is expected to be long and gradual, possibly extending to the end of this decade before the demand and price levels of the mid-to-late 1970s are seen again. At that time, the post-war baby boom will be housed and a leveling off in demand is expected.

Table 19
Projected U.S. Softwood Lumber Consumption by Markets and Principal Sources, 1983 and 1984
Million Board Feet

Item	1983	1984
Markets:		
Residential construction	13,640	14,975
Other new construction	6,200	6,500
Repair & remodeling	7,800	8,085
Materials handling	3,275	3,600
All other	3,065	3,475
Total	**33,980**	**36,635**
Source by Regions:		
Coast	6,400	6,980
Inland	7,770	8,435
California redwood	1,430	1,535
Southern pine	6,485	7,005
Other U.S.	935	1,030
Total U.S.	**23,020**	**24,985**
Imports	10,960	11,650
Total	**33,980**	**36,635**

Source: Western and Wood Products Association's "Economic Services Forecast" of September 13, 1983.

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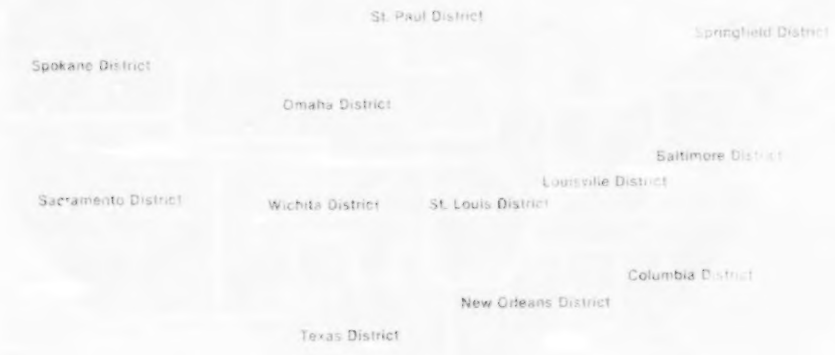

The Farm Credit Banks of Springfield

The Farm Credit Banks of Baltimore

The Farm Credit Banks of Columbia

The Farm Credit Banks of Louisville

The Farm Credit Banks of New Orleans

The Farm Credit Banks of St. Louis

The Farm Credit Banks of St. Paul

The Farm Credit Banks of Omaha

The Farm Credit Banks of Wichita

The Farm Credit Banks of Texas

The Farm Credit Banks of Sacramento

The Farm Credit Banks of Spokane

Central Bank for Cooperatives